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Global Wine War 2015: New World Versus Old

The new [EU] rules will enable the sector to continue to grow at the same time as recognizing the need to protect wines with geographical indication.[1]

— Thierry Coste, Chairman, Copa-Cogeca Wine Working Party

Everything we do will be evidence-based, data-driven, consumer-engaged and market-focused.[2]

— Brian Walsh, Chair of Australian Grape and Wine Authority

In 2015, these two views reflected the different sentiments unleashed by a fierce competitive battle raging between traditional winemakers and newer industry players as they fought for a share of the €250 billion ($280 billion) global wine market.[3] In recent decades, Old World wine producers—Italy, France, and Spain, for example—had found themselves inhibited by old winemaking traditions, restrictive industry regulations, and complex national and European Union (EU) legislation. This, plus a shift in consumer tastes and market structures, let New World companies—from Australia, Chile, and the United States, for instance—challenge Old World producers with innovations across the value chain. Now these competitors faced each other on a new front in this global wine war—a battle for China, the fastest-growing and potentially biggest export market of all time.

In the Beginning[4]

Grape growing and winemaking have been human occupations for centuries. Under the Roman Empire, viticulture spread across the Mediterranean region, making wine a peasant's drink with everyday meals. Soon, wine became part of liturgical services, and monasteries planted vines and built wineries. By the Middle Ages, vineyards became a mark of prestige among the nobility, and they began competing in the quality of wine they served—the first niche market for premium wine.

Wine Production

Historically, tending and harvesting grapes was labor intensive, and one worker could typically look after only 3 hectares (ha), approximately 7.5 acres. The introduction of vineyard horses in the early nineteenth century led to more efficient tending, with one person now able to work a 7 ha plot.

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Yet despite these efficiencies, vineyards became smaller, not larger. Over the centuries, agricultural holdings were continually fragmented as land was parceled out by kings, taken in wars, or broken up through inheritance. During the French Revolution, large estates were seized, divided, and sold off. And after 1815, the Napoleonic Code prescribed how land had to be passed on to all rightful heirs. By the mid-nineteenth century, the average holding in France was 5.5 ha and was still being subdivided. In Italy, similar events left the average vineyard at 0.8 ha.

While the largest estates made their own wine, most small farmers sold their grapes to the local winemaker or *vintner*. With payment based on weight, there was little incentive to pursue quality by reducing yield. Some small growers formed cooperatives, hoping to participate in wine making's downstream profit, but grape growing and wine making remained highly fragmented.

Distribution and Marketing

Traditionally, wine was sold in bulk to merchant traders—*négociants* in France—who often blended and bottled the product before distributing it. But poor roads and complex toll and tax systems made cross-border shipping very expensive. In the early nineteenth century, a shipment of wine from Strasbourg, France, to the Dutch border had to pass through 31 toll stations.[5] And since wine did not travel well, much of it spoiled on long journeys. As a result, only the most sophisticated *négociants* could handle exports, and only the rich could afford the imported luxury.

Innovations in the eighteenth and nineteenth centuries, such as mass production of glass bottles, the use of cork stoppers, and the development of pasteurization, revolutionized the industry. With greater wine longevity, distribution to distant markets and bottle aging of good vintages became the norm. Additional vine plantings and production followed, and a global market for wine was born.

Regulation and Classification

By the mid-eighteenth century in France, grape growing supported 1.5 million families and an equal number in wine-related businesses. Wine became France's second-largest export, accounting for one-sixth of its trading revenue. The industry's growing cultural and economic importance soon attracted political attention, and with it, laws and regulations to control most aspects of winemaking. For example, France's wine classification system was formed by a Bordeaux committee for the 1855 Exposition in Paris. To help consumers identify their finest wines, they classified 500 vineyards into five levels of quality, from *premier cru* (first growth) to *cinquième cru* (fifth growth).

Because it helped consumers negotiate the complexity of a fragmented market, this marketing tool gained wide recognition, leading the government to codify and expand it in the *Appellation d'Origine Contrôlée* (AOC) laws of 1935. These laws, still in force today, also defined regional boundaries and set tight growing and winemaking standards.[6] Eventually, more than 300 AOC designations were defined, from the well-known (Saint-Émilion or Beaujolais) to the obscure (Fitou or Saint-Péray).

Italy introduced a similar classification scheme defining 213 *denominazione di origine controllata* (DOC) regions, with regulations prescribing area, allowed grape varieties, yields, required growing practices, acceptable alcohol content, label design, and more.[7] Germany's wine classification scheme, dating from 1644, prescribed 65 classes of quality, with rules for everything from ripeness required for harvesting to minimum sugar content. As late as 1971, a new German law was passed requiring a government panel to taste each vineyard's annual vintage and assign it a quality level.[8]

Rather than resisting such government controls, producers often supported them as a way of differentiating their products and raising entry barriers. Eventually, other French wine regions were given official recognition. The classification of *vins délimités de qualité supérieure* (VDQS) was of lower rank than AOC, but above *vins de pays*—good yet inexpensive table wine. The categories were quite rigid, with almost no movement across them. This was due to a belief that quality was linked to *terroir*, the almost mystical blend of soil, aspect, microclimate, rainfall, and cultivation that the French passionately believed gave wine from each region—and indeed, each vineyard—its unique character.

But *terroir* could not guarantee consistent quality. As an agricultural product, wine was always subject to the vagaries of weather and disease. In the late nineteenth century, a deadly insect, phylloxera, devastated the French vine stock. From a production level of 500 million liters in 1876, output dropped to just 2 million liters in 1885. But a solution was found in an unexpected quarter: French vines were grafted onto phylloxera-resistant vine roots native to the U.S. and imported from the upstart Californian wine industry. It was the first time many in the Old World acknowledged the existence of a New World wine industry. It would not be the last.

Stirrings in the New World

Although insignificant in both size and reputation compared with traditional wine-producing countries, vineyards and winemakers in many New World countries dated back to the eighteenth century. In the U.S., Thomas Jefferson became a leading voice for establishing vineyards in Virginia, while in Australia, vines were brought over in the first fleet carrying convicts and settlers in 1788. Nascent wine industries were also developing at this time in Argentina, Chile, and South Africa, usually under the influence of immigrants from the Old World wine countries.

Opening New Markets

While climate and soil allowed grape growing to flourish in the New World, some cultures did not immediately embrace local wine. In Australia, the hot climate and a dominant British heritage made beer the alcoholic beverage of preference. The U.S. market was more complex: one segment followed a tradition from the rum trade era and drank hard liquor, while another group reflected the Puritan heritage of temperance. As a result, in the pre-World War II era, wine was mostly made by and sold to European immigrant communities in both these countries. But in other New World wine-producing countries, the beverage became part of the national culture. For example, per capita annual consumption reached 80 liters in Argentina and 50 liters in Chile in the 1960s—well behind the 110 liters per capita in Italy and France, but comparable with Spain.

In the postwar era, however, demand for wine increased rapidly in most New World producer countries. In the U.S., consumption grew from a post-prohibition per capita level of 1 liter per annum to 9 liters by 2006, while in Australia, it grew from less than 2 liters in 1960 to 24 liters by 2006. Such growth led to a domestic boom that boosted the young New World wine industry.

Challenging Production Norms

Riding the postwar economic boom, New World producers created wine industries quite different from their European counterparts. With widely available inexpensive land, they developed more extensive vineyards that lowered labor costs by allowing the use of equipment, such as mechanical harvesters and pruners. In 2006, the average vineyard holding in the U.S. was 213 ha, and in Australia, 167 ha. This compared to an average size of 1.3 ha in Italy and 7.4 ha in France.[9]

Unconstrained by regulation or tradition, New World producers also experimented with grape-growing practices. Controlled drip irrigation—a practice strictly forbidden under AOC regulations—

allowed Australian vineyards not only to expand into marginal land, but also to reduce vintage variability. Innovative trellis systems allowed New World producers to plant vines at twice the traditional density, while fertilizers and pruning methods increased yield and improved grape flavor. These innovations, coupled with typically sunny climates, freed New World farmers from many of the stresses of their counterparts in regions like Bordeaux, where the rainy maritime climate made late autumn harvests risky and held wine producers hostage to wide year-to-year vintage variations.

New World wine companies also broke many winemaking traditions. Most large estates had on-site labs whose analysis guided growing and harvest decisions. In the 1990s, some experimented with a reverse osmosis technology to concentrate the juice, ensuring a deeper-colored, richer-tasting wine. The technique had been developed in France, but was forbidden under AOC regulations. New World winemakers also developed processes allowing fermentation and aging in computer-controlled, stainless steel tanks rather than in traditional oak barrels. To provide the oak flavor that barrel aging offered, some added oak chips to these tanks, a practice strictly forbidden in Old World countries.

The economic impact of these and other innovations became clear in a cost comparison of popular priced wines from France's Languedoc region and Australia's Riverina district. The French grape cost of €238 per ton was 74% higher than the Australian cost of €137,[10] which translated to a juice cost of €0.32 versus €0.18 per bottle. Subsequent wholesale, retail, and tax markups amplified the impact of this difference on the final price. (See **Exhibits 1a** and **1b**.) Indeed, the industry's bottle-price multiplier rule of thumb predicted that the grape cost per ton was 100 times the average retail bottle price of entry-level and commercial premium wines.[11] Reflecting the cost discrepancies, in 2010 the price of Australian entry-level wine in Europe was around €2 a bottle, while the French *vins de pays* was above €3.

Reinventing the Marketing Model

New World producers also innovated in packaging and marketing. While the Europeans targeted the huge entry-level wine segment by selling liter bottles of table wine, in 1965 the Australians developed the innovative "wine-in-a-box" package. Employing a collapsible plastic bag in a compact cardboard box with a dispensing spigot, the box's shape and weight not only saved shipping costs, but also made storage in the consumer's refrigerator more convenient. Australian producers also began replacing corks with screw caps, even on premium wines. Providing more than cost savings, the screw caps greatly reduced spoilage due to deficient corks, particularly in delicate whites.

From their earliest experiences in the marketplace, New World producers learned the value of making wines that appealed to unsophisticated palates. While dismissed by connoisseurs, products like Ripple in the U.S. and Barossa Pearl in Australia were wildly successful. Just as important, they provided valuable lessons in branding and marketing—rare industry skills at the time. By showing wine's mass-appeal potential, they enticed Coca-Cola to acquire Taylor California Cellars in 1977, soon followed by other experienced consumer marketers such as Nestlé, Pillsbury, and Seagram. But the challenge of marketing the last largely unbranded major consumer product proved harder than expected. Within a decade the outsiders had sold out, but their influence endured in the consumer-focused attitudes and modern marketing skills they left behind.

The other big change driven by New World wine companies occurred in distribution. Historically, fragmented producers and tight government regulations had created a long, multilevel value chain, with service providers often lacking either the scale or expertise to operate efficiently. (See **Exhibit 2**.) In contrast, large New World wine companies typically controlled the full value chain, extracting margins at each stage and retaining bargaining power with the concentrated retailers. This also gave them an economic advantage by reducing handling stages and holding less inventory. Because their name was on the final product, they controlled quality at every step.

Traditionalists argued that the New World's drive for efficiency and desire to cater to simple palates had compromised the character of its wines. But they were shocked that these "engineered wines" were often sold under French appellation names like Chablis, Burgundy, or Champagne. So when the EU took legal action, New World winemakers began identifying their wines by grape variety. Eventually, consumers learned to recognize varietal names and developed taste preferences defined by pinot noir versus merlot, or chardonnay versus sauvignon blanc. Indeed, many found this easier to understand than the complex regional designations that Old World winemakers used.

The Judgment of Paris

On May 24, 1976, a British wine merchant set up a blind-tasting panel to rate top wines from France and California. Despite the huge "home field advantage" of an event held in Paris with a judging panel of nine French wine critics, the American entries took top honors in both red and white competitions. When French producers complained that "The Judgment of Paris" was rigged, a new judging was held two years later. Again, Californian wines triumphed.[12]

The event was a watershed in the industry. To the great shock of those who dismissed the New World's innovative approaches, the event raised awareness that they produced quality wines. It was also a wake-up call to traditional producers who began taking these new challengers seriously. And finally, it gave confidence to New World producers that they could compete in global markets. In short, it was the bell for the opening round in a fight for export sales.

Maturing Markets, Changing Demand

"The Judgment of Paris" triggered a revolution in the wine industry that raged into the twenty-first century. In the decades that followed, traditional producers were shocked by alarming trends: a 14% drop in worldwide consumption from the 1980s to the 2010s,[13] radical changes in consumer tastes, consolidation in the distribution channels, and shifts in government support. But most New World producers saw the changes differently—as opportunities to disrupt the existing order.

Changing Global Demand Patterns

The most dramatic decline in demand occurred in the highest-consumption countries. Rates of per capita consumption in France and Italy in the 1970s more than halved by the end of the century.[14] (See **Exhibit 3**.) Causes included the different drinking preferences of a new generation, an older generation's concern about health issues, and stricter drunk-driving penalties. The downward trend continued into the twenty-first century. Between 2000 and 2012, consumption in France declined by 12%, by 27% in Italy, and by 34% in Spain. But in the same period, major importing countries were booming: UK demand was up by 29%, the U.S. by 37%, and China by an impressive 67%.[15] By 2014, China's consumption outpaced Spain's, Argentina's, and the UK's. (See **Exhibit 4**.) Its low per capita consumption clearly offered huge growth potential in a country of 1.3 billion people.

Rise of Fashion, Shift to Quality

As demand moved to new markets, consumption patterns shifted. A decline in working families' daily consumption of table wine was offset by upscale urban consumers' purchases, typically made on the basis of brand, grape variety, region—and, increasingly, fashion. The emphasis on lighter foods in the 1980s increased demand for white wines, which by the end of the decade represented over 75% of U.S. sales. But this changed dramatically following a 1991 *60 Minutes* TV report that identified red wine as part of the "French paradox"—low rates of heart disease in a country known for its rich food. Red wine's market share grew from 27% in 1991 to 43% in 1996. By 2010 white wine had lost its dominance, as red wine grapes reached 55% of global vineyard coverage.[16]

Demand for grape varieties also moved with fashion. During the white wine boom, chardonnay was the grape of choice, but by the late 1990s, sauvignon blanc emerged as a new trendy white varietal. In red wine, a love affair with cabernet sauvignon was followed by a mini-boom for merlot, which in turn was succeeded by a demand spike for pinot noir.

For Old World growers constrained by limited space and tight regulations, the inability to respond to these changes cost them dearly. Although vines had a productive life of 60 to 70 years, they could take 3 or 4 years to produce the first harvest, 5 to 7 years to reach full productive capacity, and 35 years to produce top-quality grapes. So, for example, a trend away from sweeter to drier white wines was disastrous for the German industry. With strict requirements on sugar content, German producers saw exports drop from over 3 million hectoliters in 1992 to under 2 million just five years later. In contrast, New World wine regions responded rapidly to demand shifts. For example, in the 1990s, California acreage planted with chardonnay increased 36%, and merlot plantings grew 31%.

Simultaneously, another market change emerged to challenge producers. Partially offsetting stalled volume growth, demand for higher-quality wines grew through the 2000s. (See **Exhibit 5**.) This was to some extent the result of the global financial crisis of 2008: while some consumers traded down to entry-level wines, others took the opportunity to try heavily discounted premium ones. Once the economy improved, many consumers opted to stay with the premium wines.[17]

Increasing Distribution Power

Because marketing was usually handled by *négociants*, Old World producers were often insulated from these trends. In contrast, most large New World wine companies controlled distribution from vineyard to retailer. This allowed them to sense and respond to retailers' need for consistent supply, strong brands, good price/quality ratio, and strong promotion support.[18] Yet when fragmented French producers tried to respond, their lack of consumer knowledge and marketing skills was compounded by their limited bargaining power, often forcing them to compete on price.[19]

Even transport economics that once favored Old World suppliers' proximity to European markets changed. As trucking costs rose, container ship rates fell, making the cost of shipping wine from Australia to the UK similar to trucking it from southern France. Then Australia started shipping bulk wine in large plastic bags to be bottled at the destination, reducing shipping costs by up to €2.30 a case.[20] Bulk wine grew from one-third of New World exports in 2006 to nearly half in 2013.[21]

Ascendancy of Brand Power

For years, the wine industry seemed ripe for branding. But extreme fragmentation in the European industry (Bordeaux alone had 20,000 producers) meant that few had the volume to support branding strategies. Historically, only the handful of Old World producers whose wines achieved icon status—Lafite, Veuve Cliquot, and Château d'Yquem, for example—were recognized brands based on image and quality. But these appealed to the elite, only a tiny fraction of the global market.

Government-supported classifications, such as France's AOC, had been partially successful in ensuring the quality and consistency that brands offered. But consumer confidence eroded over time as low-quality producers rode on the classification's prestige. For example, while most wine from Burgundy's most famous vineyard Chambertin was worthy of its *grand cru* status, wine critic Robert Parker described some that sold at €140 a bottle under the Chambertin name as "thin, watery, and a complete rip-off."[22] In Italy, DOC regulations were so often violated that in 1980, the government had to introduce the DOCG classification where G stood for *garantita* (guaranteed). And in Germany, government standards were so diluted that, even in mediocre years, over 75% of wine was branded *Qualitätswein* (quality wine), while less than 5% was labeled the more modest *Tafelwein* (table wine).

Classification schemes were also impeded by their complexity—there were 327 designated AOC regions—requiring consumers to understand the intricacies of region, vintage, and vineyard reputation in order to choose a bottle. And even if they found a wine they liked, by their next purchase, it might not be in stock or a new vintage might be less appealing. Consumers were often faced with too many options and too little knowledge to make an informed choice.

Yet while global brands dominated soft drinks, beer, and liquor, no wine brand had ever captured even 5% of the global market. In the 1960s and 1970s, European producers had launched several mass-appeal brands such as Lancers, Blue Nun, and Mateus. But such initiatives had not endured. In contrast, New World producers had made branding a core marketing skill. For example, Australian winemaker Penfolds had built trust in its products by ensuring the vintage-to-vintage consistency that branding demanded**.** It then leveraged its trusted brand name by creating a hierarchy of wines, allowing consumers to move up each step from $9 to $185 (€6 to €130) wines as their tastes—and their budgets—developed. (See **Exhibit 6**.) Many other New World producers replicated this strategy.

By building marketing expertise in their home markets during the 1960s and 1970s, New World producers learned how to respond to consumer preferences for simpler, more fruit-driven wines that were easy to appreciate. They then took those wines and their marketing and branding skills into the export markets. For instance, in the 2000s, Yellow Tail, a full-bodied, fruit-driven wine with a trendy Australian label, came to dominate the low to middle segments of the U.S. market.

All these changes resulted in significant shifts in the world ranking of wine companies. Despite their newness and the comparative smallness of many of their home markets, the New World was home to 7 of the 10 top wine companies in the 2010s, a list previously dominated by the Old World. And by 2014, the world's top-10 wine brands all came from the New World. (See **Exhibits 7a** and **7b**.)

Facing Challenges, Seeking Solutions

Of all these challenges, the biggest for traditional producers was that falling demand in their home markets and a loss of share in export markets had caused a structural wine surplus—dubbed the European wine lake. (For example, **Exhibit 4** shows that French wine production in 2014 was 46,698 kilo hectoliters (khl). Domestic consumption was 27,900 khl, including 6,453 khl of imports. Exports were 14,387 khl, leaving a surplus of 10,864 khl.) The EU's response was to pay farmers to uproot vineyards, with a parallel program to purchase excess for distillation into industrial alcohol. Yet after distilling 24.5 khl of wine from 2000 to 2008, the EU recognized that by guaranteeing a market for overproduction at attractive prices, the program exacerbated the problem.[23]

In 2008, the EU introduced policies to encourage commercially viable wines by phasing out crisis distillation, expanding uprooting efforts, and increasing its export promotion budget. The EU also created a new classification system, albeit one that could be superseded by a country's traditional system such as France's AOC. The top EU level of Protected Designation of Origin (PDO) required that all grapes be sourced from a defined region; next, the Protected Geographical Indication (PGI) level required that only 85% of grapes be from a protected region; and the third category, simply called "vin," had no geographic indication and could be identified by varietal. Yet one industry insider commented that "[t]he EU missed the chance to produce a new quality-based system . . . and has gone for the old terroir-based system, rehashed to frustrate New World producers."[24]

Meanwhile, New World producers were burdened by image problems born of their willingness to lower prices aggressively in an era of excess supply. Australia had enjoyed success from 1996 to 2006—under the "Brand Australia" umbrella—as grape production more than doubled and exports grew 530% to 782 million liters, making it the world's number-four wine exporter. But growth eventually began to stagnate and average price eroded. Exports to the UK, its largest market, peaked at 807 million liters in 2007, then started to slide.[25] By 2009, Australia was producing 20 to 40 million cases more than it could sell.[26] Australian wine had become trapped by the "cheap and cheerful" image that brands like Yellow Tail had promoted so successfully.

Furthermore, increases in global energy prices and the cost of water in the midst of an ongoing drought boosted Australian production costs by $200 (€215) a ton. And appreciation of the Australian dollar from A$0.58 to €1 in 2001 to A$0.74 a decade later also increased export prices.[27] By 2010, Australian producers were forced to recognize that while they could land bulk table wine in the U.S. around $0.72 (€0.54) a liter, Chile's price was $0.58 (€0.44) a liter.[28] Australia's wine-governing bodies called for a restructuring of the industry with initiatives to manage supply and a commitment to undertake industrywide R&D, emphasizing research on the fast-growing market in China.

The Battle for the China Market

Squeezed by chronic oversupply and declining demand in mature markets, in the early twenty-first century, Old and New World producers were again locked in a competitive battle for export markets that accounted for 35% of global production.[29] But New World producers now exported 30% of their output, up from 3% in the 1980s.[30] (See **Exhibit 8**.) It was a situation that made China—called "the decade's most attractive wine market"[31]—a vital battleground in the global wine war.

Building on China's Wine Heritage

China's modern winemaking was born in 1892 when a wealthy Chinese businessman imported grapevines and winemakers from Europe to create Changyu Pioneer Wine (Changyu). Yet, for years, interest in wine was extremely limited, and the few who did drink it preferred either a fruity, syrup-like wine or wine made from grape juice concentrate and water. The wine industry resurfaced after the easing of Communist rule in 1978 as China opened up to the outside world. Economic reforms allowed the creation of new wine companies: in 1980, Dynasty Fine Wines Group (Dynasty) formed as a joint venture between state-owned Tianjin City Grape Garden and French producer Rémy Martin; and in 1983, state-owned China National Cereals Oils and Foodstuffs Corporation (COFCO) started the Great Wall Wine Company. Together, Changyu, Dynasty, and COFCO shaped the growing industry.

Wine consumption flourished in the 1990s as China chased aggressive gross domestic product (GDP) targets and household wealth increased. In 1996, Premier Li Peng toasted Congress with a glass of red wine and spoke of the health benefits of drinking wine over the harsh *baijiu,* a popular grain spirit. Some felt his motivation was also to protect China's grain supply, since it took two kilograms of staple crops like rice or barley to make one liter of *baijiu*. Grapes, in contrast, grew in soil unsuitable for other crops.[32] China's wine market took off and grew 20% a year from 2000 to 2009—the fastest rate in the world.[33]

Establishing the Domestic Wine Industry

Most Chinese wine was priced to maximize volume and was below global standards, though some small wineries emerged with a focus on quality.[34] Part of the problem was sourcing: farmers, typically paid by weight, often produced grapes with sugar levels and acidity unsuitable for winemaking.[35] Since wines labeled "Product of China" required that only 10% of grapes be locally sourced, producers blended domestic wine with imported bulk wine, mostly from Australia and Chile. So while China's vineyard acreage doubled in the 2000s, wine production grew even faster.[36] In 2011, China's goal was to produce 2.2 billion liters annually by 2015, which some saw as a potential threat to the Old World.[37] At that time, France led global production at 5.2 billion liters.[38]

Investing heavily in marketing, the big domestic wine companies had broad brand recognition. Dynasty, for instance, typically committed 20% of its revenue to marketing, while COFCO leveraged its brand by becoming the exclusive wine supplier for the 2008 Beijing Olympics.[39,40] Local producers opened French-like châteaux in China and adopted labels that copied the French style.

Wine became a prestige product, commonly served at lavish banquets and given as high-status gifts among government officials. While this caused the top segment to grow, domestic entry-level wine dominated most other consumption. Red wine accounted for 90% of consumption, in part due to its ties with rich Western traditions, but also because it paired well with China's savory and spicy dishes.[41] Few drinkers understood varietal differences, but favored cabernet sauvignon and merlot.[42] China's brand-conscious consumers therefore made purchases based on image and price rather than taste, and it was common to mix wine with sweet sodas to make it palatable.

Navigating the Import Challenges

With domestic production lagging demand growth, a large import market opened up. But foreign producers had to navigate complex regulatory requirements: import laws varied by province and a bottle typically took four months to clear customs.[43] As a result, Hong Kong became a key entry point. After eliminating its 40% wine import tax in 2008, 40% of its imports were re-exported to China.[44]

Good local agents were vital. Large state-owned importers had experience clearing customs, but many lacked proper temperature-controlled transport equipment, sometimes leaving wine to spoil in the heat.[45] Importers often signed distribution agreements for foreign wines but did little to promote them, instead prioritizing a few that sold with little marketing—often their Bordeaux wines. So while imports were valued for their prestigious image, few achieved widespread brand recognition.[46]

Imports faced additional obstacles in the retail market. High markups were common: a €1 to €2 bottle in Europe could sell in China's stores for RMB 70 to RMB 100 (€9 to €12).[47] This was partly due to China's duty (up to 48%), but also reflected the uneducated consumer base.[48] At hotels, restaurants, and bars, imported wines were also subject to extra "introduction and promotion" fees. Foreign wine producers also faced another challenge: counterfeit wines. Local suppliers sold cheap local wine as premium imports under labels with fictitious French appellations or misspelt versions of prestigious brands. For example, a "Benfolds" brand mimicked the respected Australian Penfolds brand, and undiscerning consumers could not tell the difference.[49]

Local and foreign companies alike worked to develop a wine culture by educating consumers through classes and wine tastings. Wine drinkers gradually learned to appreciate and seek out better quality, and the volume of bottled wine imports finally surpassed bulk in 2009.[50] Although only 3% of the population drank wine,[51] China had become the world's fifth-largest wine market.

France: Capitalizing on a Premium Image

France stepped in to fill China's growing luxury segment, and its imports grew 15-fold from 2002 to 2008.[52] Chinese consumers admired France's prestigious wine reputation and relied on the AOC classification to determine quality, with ranking reflected in price. Bordeaux's Lafite led the surge; demand and prices soared with Chinese importers' huge orders. Lafite's prices peaked in 2010 at a Sotheby's auction in Hong Kong, where bottles worth a total of €1.8 million sold for €6.3 million.[53] Its 2008 vintage, labeled with the Chinese good luck number eight, sold for four times its value.[54]

As demand for Bordeaux spiked, the region's export promotional activities centered on the 200 most prominent châteaux, leaving its small and medium-sized wineries to promote on their own.[55] Already financially strained, and with some nearing bankruptcy, many offered their excess supply to *négociants,* who blended it into low-price wine sold in China with a Bordeaux label. This allowed France, with imports to China totaling €135 million in 2009, to gain a position at both the high end (above RMB 400, or €40) and low end (under RMB 50, or €5) of the market.[56] (See **Exhibits 9a** and **9b**.) But wine was still a luxury product mainly purchased by China's urban upper-middle class, and some top French producers warned that the low-quality wine would dilute their image.[57]

Other clouds were on the horizon. France's success in China resulted in its established customers being priced out of the market, with one American buyer saying that Bordeaux needed to reduce its prices "to fit the budgets of middle managers in Chicago rather than tycoons in Chengdu."[58] Then, some Chinese buyers started bypassing France's *négociant* system, with several châteaux offering buyers direct allocations. This raised fears that they would undermine France's strong worldwide distribution networks built over centuries.[59] Then, responding to buyer pressure, *négociants* sought Chinese joint-venture partners to protect profits. Meanwhile, Chinese investors were buying up Bordeaux châteaux, and from 2009 to 2014, 60 French châteaux came under Chinese control.[60]

Australia: Building a Value Image

During the 2000s, Australia also became a major exporter to China, largely by exporting surplus bulk wine, which accounted for 50% of its exports to China in 2009, up from 18% in 2008. This shift led to a drop in average price per liter from 3.75 Australian dollars (A$; €2.10) to A$1.40 (€0.80).[61] Much of the Australian bulk was blended to improve the quality of local Chinese wine, eliminating the Australian brand in the process.[62] Bulk wines the bottled under a Chinese label were slotted along with other New World offerings in the low-price segment, slightly above the domestic brands.[63]

At the same time, Australia looked to China as a potential market for its bottled wines. Because its wines did not yet command the same respect as France's, the Australian industry invested heavily in education through trade shows, social media campaigns, retail promotions, tasting roadshows, and classes.[64] These activities helped improve the image of Australian wine, and soon Chinese consumers started to recognize it as good value for the price.[65] China became a popular market for Australia's bottles over RMB 70 (€7), sales of which grew from A$4 million (€2.3 million) in 2005 to A$33 million (€18.7 million) in 2009—a quarter of its Chinese export value that year.[66] By 2010, China was Australia's fastest-growing export market and its fourth largest by volume.

Austerity Restructures the Market

In 2012, as the Chinese economy began to slow, new austerity measures curtailed official banqueting and prohibited expensive gifts among government employees. Demand for fine wine plummeted and overall wine sales grew sluggish. Within a year, French imports fell by 18% in value[67] as Chinese buyers canceled orders worth millions of dollars.[68] As Chinese consumers started to look beyond Bordeaux, opportunities opened for less expensive yet still top-range imports, like France's Burgundy or Australia's Penfolds Grange.[69] So while Australia's exports to China slowed from 2012 to 2013, its average value per liter increased to A$6.76 (€4.90)—above France's €3.77.[70] Domestic producers also sought better regulation to improve wine quality as the industry restructured to meet the changing demands. Indeed, a Chinese wine region even created a classification system that mirrored France's.[71]

Regular consumers gradually replaced government employees as the driver of demand as wine transformed from a gift to give to a beverage to drink, particularly among white-collar workers and young people. Consumers started to try a wider variety of wines and in many cases found they preferred the lighter, fruitier wines of the New World to the tannic reds of the Old.[72]

By 2014, entry-level wines accounted for 80% of consumption, primarily made up of domestic wines retailing for under RMB 50 (around €6).[73] Imports, which averaged RMB 150 (around €20) or above, dominated the shrinking top range.[74] Yet following the austerity measures, prices started to drop and high-end consumers traded down. At the same time, entry-level consumers grew more knowledgeable and started looking for more mid-price wines in the premium segment. These changing dynamics opened a new playing field in the mid-level segment (RMB 50 to RMB 150).[75]

Battle Lines Re-Drawn: New Strategies for France and Australia

In the mid-2000s, France's high-end wines remained popular worldwide, while its low- and mid-priced wines were losing share to the New World. In 2008, the French industry launched a five-year industry modernization plan to boost competitiveness with the self-contradictory-sounding goal "to keep tradition in place and at the same time gear the sector towards mass production."[76]

The reform's core element, fully implemented in 2012, was a new French classification system. The essentially unchanged AOC was renamed *Appellation d'Origine Protégée* (AOP). AOP production rules were largely governed by regional committees, while the national government gave marketing support.[77] The next classification level was now called *Indication Géographique Protégée* (IGP), with wines identified by broad regions and made from any varietal. This allowed the employment of New World winemaking techniques, such as using oak chips in place of oak barrel aging or adding powdered tannins.[78] The third level was *vin de France*, wines identified by varietal and blended from grapes across multiple regions. While some in the industry considered the changes "a violation of our wine heritage,"[79] sales of these low- and mid-priced *vin de France* wines were soon on the rise.

In 2010, the Bordeaux wine industry body launched its own three-year revitalization plan with a focus on promoting mid-priced wines to eight key markets, including China.[80] The plan introduced a new price-based segmentation system with four tiers: Art (over €20), Exploration (€6 to €20), Fun (€2 to €6), and Basic (under €2). Amid concerns that low-quality wines diminished the Bordeaux image, production of Basic wines would be reduced by 110 million liters.[81]

At the EU level, as exports increased 10% annually from 2010 to 2012, regulators were cautiously optimistic about their own 2008 reforms.[82] But while the vineyard uprooting program had removed 10.2 million hectoliters (hl) of wine by 2012, surplus production—the wine lake—endured.[83] In 2013, the EU doubled its wine promotion budget and introduced reforms to improve marketability through new products, processes, and technologies.[84] But in 2014, the European Court of Auditors criticized that funds had been used to consolidate markets rather than win new ones and had mostly supported large enterprises, not the small and medium-sized ones struggling the most.[85]

In 2013, the EU also proposed loosening restrictions on planting rights to allow vineyards beyond traditional wine regions. Many worried that this would lead to further overproduction, lower quality, lower prices, and the disappearance of family farms.[86] But after much debate, the EU lifted the restrictions in 2015, but limited the size of new vineyards to 1% of a country's production.[87] Despite the compromise, one French politician opined, "This rule spells the death of the [AOC] system. . . . Terroir, the quality of the earth, exposure to the sun—they will count for nothing."[88]

Australia, meanwhile, focused on its deteriorating image and the declining average price of its wine exports. To provide support, in 2013 the government merged its two wine groups to form a new statuary body known as Wine Australia. In 2015, the new body introduced a strategic plan to boost demand, lift the price premium, and increase the global competitiveness of Australian wine. It focused marketing on the premium segment, promoting wines that reflected Australia's terroir and elevated the image of all wines.[89] The group also expanded growing and winemaking R&D.

Australia's hopes were revived in 2015 as its exports increased by 6.4% in volume and 14.0% by value from 2014, indicating a big rise in its premium wine sales.[90] The average global value of its bottled wine exports reached A$5.50 (€3.70) per liter, the highest price since 2003.[91] And exports of bottles over A$10 (€6.80) per liter grew 35% to reach record levels of A$480 million (€330 million).[92]

On the Chinese Battlefield

In 2015, these strategic maneuvers were all playing out in China, the new battlefield in the global wine war. The market had revived somewhat since the austerity measures; Chinese consumers were drinking more frequently and seeking out better value. In 2015, Chinese wine imports reached RMB 12 billion (€1.7 billion),[93] with France leading in value (45% import market share) and volume (43%). But Australia, third in volume (14%) and second in value (23%), was closing the gap.[94]

France could no longer ride on its image to ensure top prices for its fine wines and increasingly promoted its mid-level wines. *Vin de France*'s trade organization launched promotional events, tastings, and educational seminars that helped to boost sales in China by 12% from 2013 to 2014. By 2014, China accounted for 13% (37.9 million bottles) of *vin de France*'s total export volume.[95] Bordeaux producers also decided to back their new mid-range Exploration tier with promotional efforts. A 2014 advertising campaign positioned mid-range "Vins de Bordeaux" as innovative, approachable, and affordable—a shift from its historic reputation.[96] In China, an image of chopsticks holding a Bordeaux bottle demonstrated that the wines paired well with diverse cuisines.[97]

As Chinese consumers moved to the middle market, Australia's simpler brands and good mid-priced wines became the new favorites.[98] But a declining Australian dollar and a free trade agreement with China also boosted Australia's higher-end prospects. Import tariffs on Australian wine were to be reduced from 2015 levels of 14% for bottles and 20% for bulk to elimination by 2019. In this environment, Wine Australia worked with high-end Chinese retailers to increase the visibility of its premium wines though educational activities and new marketing efforts for premium wines. For example, Treasury Wine Estates, owner of the Penfolds and Wolf Blass brands, responded to Chinese perceptions of quality by replacing screw caps with corks.[99] And to reach the younger generation, in 2015 Wolf Blass became a sponsor of China's National Basketball Association.[100] Treasury then brought its distribution in-house in 2015, reducing the distributor markup to make premium wines more affordable, while also increasing the company's margin.[101]

Together, these factors made 2015 the best year for Australian exports since 2007.[102] From 2014 to 2015, its wine exports to China grew 66% to reach A$370 million (€250 million), while the value of bottle wine exports averaged A$6.41 (€4.34) per liter.[103] Indeed, some expected it to overtake the UK as Australia's second-largest export market.[104]

In 2015, China also became the top destination of Australia's premium wine exports, confirmed by the fact that Penfold's Bin 407 was vying for top position among China's imports.[105] Compared to France's Lafite, Bin 407 was considered more affordable yet still prestigious and high quality. With new high-status images and portfolios spanning many price segments, Penfolds and its Australian counterparts were poised to battle France for dominance in the large, growing, and fast-changing Chinese market. The global wine wars were entering a new phase.

Exhibit 1a Retail Price Structure of a Typical EU Wine in Select Export Markets (€ per bottle), 2014

	China		United Kingdom		Germany	
	%	€/bottle	%	€/bottle	%	€/bottle
Grape, winemaking and bottling cost		2.00		2.00		2.00
Transportation cost		1.10		0.18		0.20
Landed cost (inc. insurance and freight)		3.10		2.18		2.20
Add Customs duties	14%	3.53	0%	2.18	0%	2.20
Add Excise duties	10%	3.89	€2.42[a]	4.60	0%	2.20
Add VAT	17%	4.55	20%	5.52	19%	2.57
Add Importer's margin	25%	5.69	10%	6.07	10%	3.22
Add Retailer's margin	50%	8.53	32%	8.01	32%	4.83

Source: Adapted from COGEA S.r.l., "Study on the Competitiveness of European Wines," European Commission, October 2014, p. 94, http://ec.europa.eu/agriculture/external-studies/2014/eu-wines/fulltext_en.pdf, accessed May 2016.

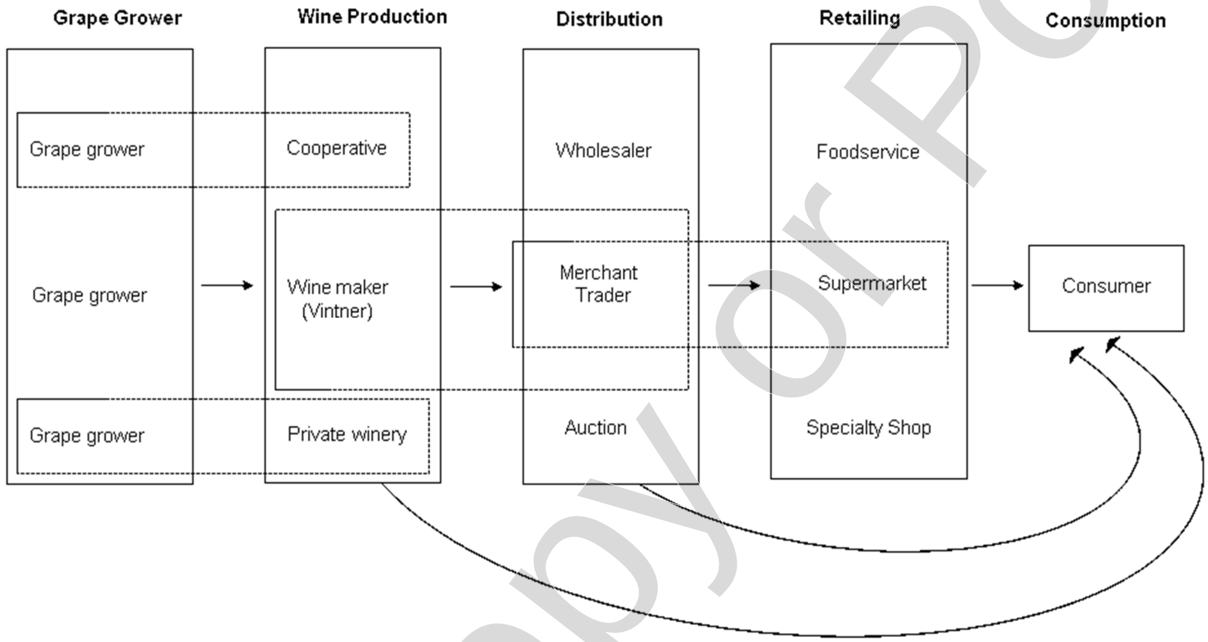
[a] UK excise duty was calculated on volume and alcohol content, not as a percentage.

Exhibit 1b Bottle Wine Segments by Retail Price (European Commission's Categories), 2014

	Medium Range			
Entry Level	Commercial Premium	Super Premium	Ultra-Premium	Top Range
≤ 4.99 €/lt	5.00–9.99 €/lt	10.00–14.99 €/lt	15.00–49.99 €/lt	50.00 €/lt and more

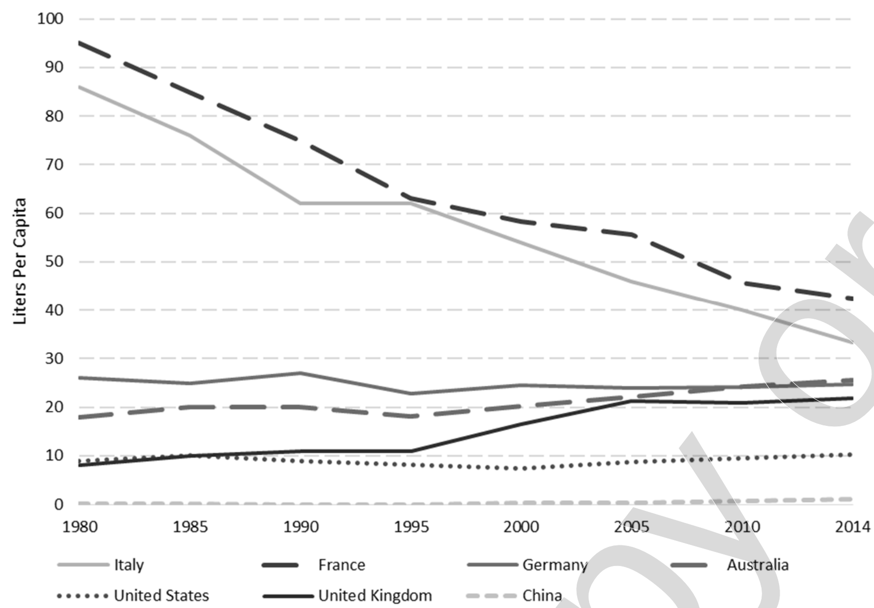
Source: COGEA S.r.l., "Study on the Competitiveness of European Wines," European Commission, October 2014, p. 66, http://ec.europa.eu/agriculture/external-studies/2014/eu-wines/fulltext_en.pdf, accessed March 2016.

Exhibit 2 Wine Industry Value Chain



Source: Adapted from *The World Wine Business*, Rabobank Market Study, May 1999.

Exhibit 3 Wine Consumption Per Capita, Selected Countries (1980–2014)



Source: Compiled by casewriter from *The World Wine Business,* Rabobank Market Study, May 1999; Wine Institute, "Statistics," http://www.wineinstitute.org/resources/statistics, accessed February 2016; and Kym Anderson and Signe Nelgen, *Global Wine Markets, 1961 to 2009: A Statistical Compendium* (Adelaide, Australia: University of Adelaide Press, 2011), https://www.adelaide.edu.au/wine-econ/databases/GWM/, accessed March 2016.

Exhibit 4 Wine Production and Consumption: Selected Old World and New World Countries, 2014

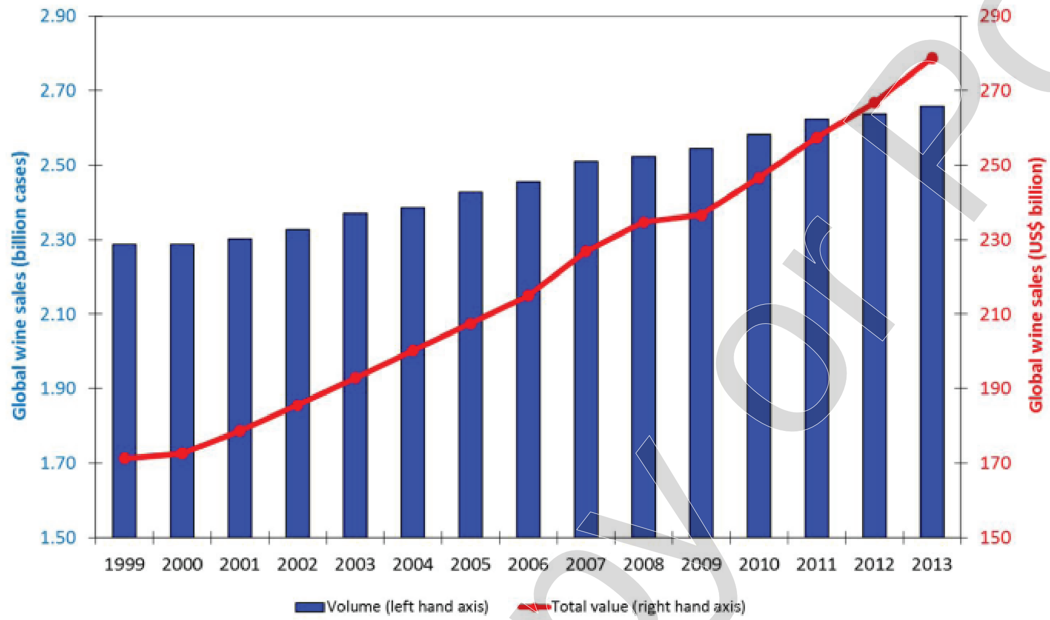
	Consumption		Production[b]	Exports		Imports	
	Liters per Capita	Total (khl[a])	Total (khl)	Volume (khl)	Value (€ millions)	Volume (khl)	Value (€ millions)
Argentina	23.5	9,900	15,197	2,626	631	-	-
Australia	24.5	5,400	12,000	7,301	1,262	840	443
China	1.2	15,800	11,178	-	-	4,578	1,145
France	42.5	27,900	46,698	14,387	2,468	6,453	620
Germany	24.8	20,200	9,334	3,863	968	15,171	2,505
Italy	33.3	20,400	44,739	20,540	5,078	2,440	310
Spain	21.3	10,000	41,620	22,560	2,468	470	153
UK	22	12,600	-	-	-	13,388	3,595
U.S.	10.3	30,700	22,300	4,045	1,103	10,739	4,032

Source: Compiled by casewriter from Wine Institute Statistics, 2015, http://www.wineinstitute.org/files/World_Per_Capita_Wine_Consumption_Revised_Nov_2015.pdf; "State of the Vitivinculture World Market," Organisation Internationale de la Vigne et du Vin, April 2015, http://www.oiv.int/public/medias/2935/oiv-noteconjmars2015-en.pdf; "EU-27 Wine Annual Report and Statistics 2015," Global Agricultural Information Network, February 24, 2015, http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Wine%20Annual_Rome_EU-28_3-16-2015.pdf; and "Wine Industry Statistics," Winetitles Media, http://winetitles.com.au/statistics/default.asp, all accessed February 2016.

[a] kilo hectoliter (khl) was 1,000 hectoliters.

[b] In several European countries, production did not equal consumption (plus exports minus imports) due to excess production being subject to government purchase.

Exhibit 5 Global Wine Sales by Volume and Value (1999–2013)



Source: Euromonitor International in Australian Grape and Wine Authority, "Strategic Plan 2015-2020," n.d., p. 33, https://www.wineaustralia.com/en/About%20Us/~/media/AGWA%20Strategic%20Plan%202015-2020.ashx, accessed January 2016.

Note: The average exchange rate over the period was $1 = €0.84. (In 1999, $1 = €0.93. In 2013, $1 = €0.75.)

Exhibit 6 Penfolds Red Wine U.S. Brand Structure, 2009

Label	Varietal Type	Years Before Release	Price Segment	Suggested U.S. Retail Price per Bottle ($US)
Rawson's Retreat	Varietal range[a]	1	Premium	$8.99
Koonunga Hill	Varietal range[a]	1-2	Premium	$10.99
Thomas Hyland	Varietal range[a]	1-2	Premium	$14.99
Bin 138	Shiraz Mourvedre Grenache	2	Super Premium	$19.00
Bin 128	Shiraz	3	Super Premium	$24.00
Bin 28	Shiraz	3	Super Premium	$24.00
Bin 389	Cabernet Shiraz	3	Super Premium	$26.00
Bin 407	Cabernet Sauvignon	3	Super Premium	$26.00
St. Henri	Shiraz	5	Ultra Premium	$39.00
Magill Estate	Shiraz	4	Ultra Premium	$50.00
RWT	Shiraz	4	Ultra Premium	$69.00
Bin 707	Cabernet Sauvignon	4	Ultra Premium	$80.00
Grange	Shiraz	6	Icon	$185.00

Source: Southcorp Wines, the Americas.

[a] Typical red varietal range of these brands included merlot, shiraz cabernet, and cabernet sauvignon. (These brands also offered a range of white wines.)

Exhibit 7a Top-10 Global Wine Companies by Volume, 2003 and 2014

2003			2014		
Rank	**Company**	**Country**	**Rank**	**Company**	**Country**
1	Constellation Brands	U.S.	1	E&J Gallo Winery	U.S.
2	Bacardi & Co	Italy	2	Constellation Brands	U.S.
3	E & J Gallo Winery	U.S.	3	The Wine Group	U.S.
4	The Wine Group	U.S.	4	Treasury Wine Estates	Australia
5	Foster's Group	Australia	5	Accolade Wines	Australia
6	Les Grands Chais	France	6	Viña Concha y Toro	Chile
7	Pernod Ricard Groupe	France	7	Castel Groupe	France
8	Peñaflor	Argentina	8	Group Peñaflor	Argentina
9	Viña Concha y Toro	Argentina	9	Pernod Ricard Groupe	France
10	Castel Groupe	France	10	Cantine Riunite & CIV SC	Italy

Source: Compiled from Kym Anderson and Signe Nelgen, *Global Wine Markets, 1961 to 2009: A Statistical Compendium* (Adelaide, Australia: University of Adelaide Press, 2011), https://www.adelaide.edu.au/wine-econ/databases/GWM/; and Jeremy Cunnington, "Spirits and Wine: Corporate Overview," Euromonitor International, February 2016, p. 11, accessed February 2016.

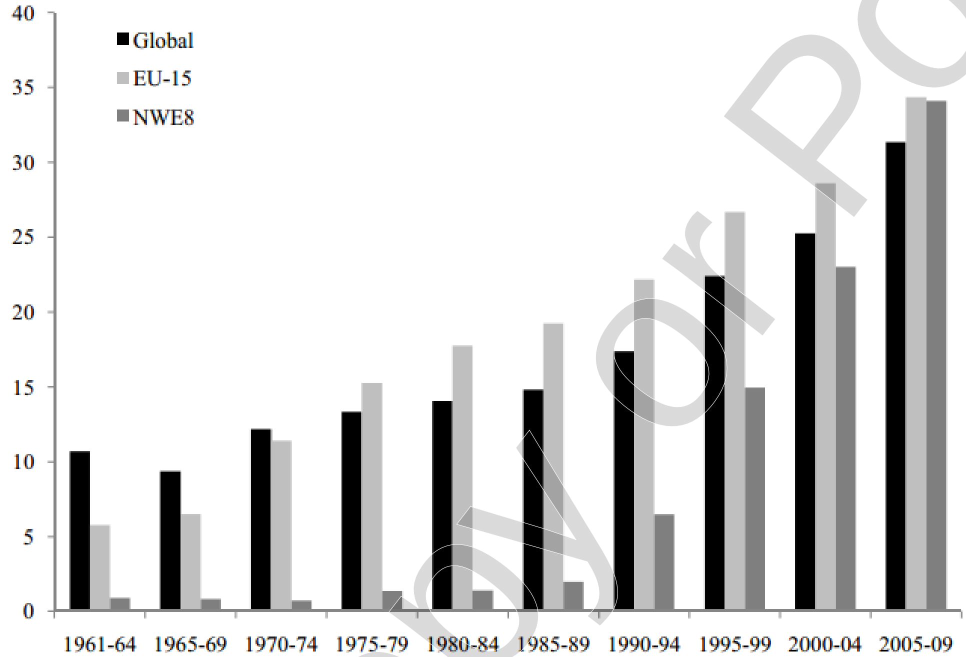
Note: Treasury Wine Estates was formerly a part of Foster's Group.

Exhibit 7b Top-10 Global Wine Brands, 2009 and 2014

	2009				2014		
	Brand	**Brand Owner**	**Country**		**Brand**	**Brand Owner**	**Country**
1	Gallo	E&J Gallo	U.S.	1	Barefoot	E&J Gallo	U.S.
2	Concha y Tora	Concha y Tora	Argentina	2	Gallo	E&J Gallo	U.S.
3	Moët et Chandon	LVMH	France	3	Concha y Toro	Concha y Toro	Chile
4	Veuve Cliquot	LVMH	France	4	Robert Mondavi	Constellation	U.S.
5	Robert Mondavi	Constellation	U.S.	5	Sutter Home	Trinchero Family Estates	U.S.
6	Yellowtail	Casella Wines	Australia	6	Yellow Tail	Casella Wines	Australia
7	Hardys	Constellation	Australia	7	Hardys	Accolade Wines	Australia
8	Beringer	Foster's Group	U.S.	8	Lindeman's	Treasury Wine Estates	Australia
9	Freixenet	Freixenet	Spain	9	Beringer	Treasury Wine Estates	Australia
10	Jacob's Creek	Pernot Ricard	Australia	10	Jacob's Creek	Pernod Ricard	Australia

Source: Compiled from Kym Anderson and Signe Nelgen, *Global Wine Markets, 1961 to 2009: A Statistical Compendium* (Adelaide: Australia: University of Adelaide Press, 2011), https://www.adelaide.edu.au/wine-econ/databases/GWM/; and Gabriel Stone, "Top 10 Wine Brands 2015," *The Drinks Business*, April 7, 2015, http://www.thedrinksbusiness.com/2015/04/top-10-wine-brands-2015/11/, accessed February 2016.

Exhibit 8 Exports as % of Production Volume by Source: EU, New World, and Globally, 1961–2009



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Note: EU-15 included Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom. NWE8 included Argentina, Australia, Canada, Chile, New Zealand, South Africa, United States, and Uruguay.

Exhibit 9a China Wine Sales Volume by Retail Sale Point and Country of Origin, 2009

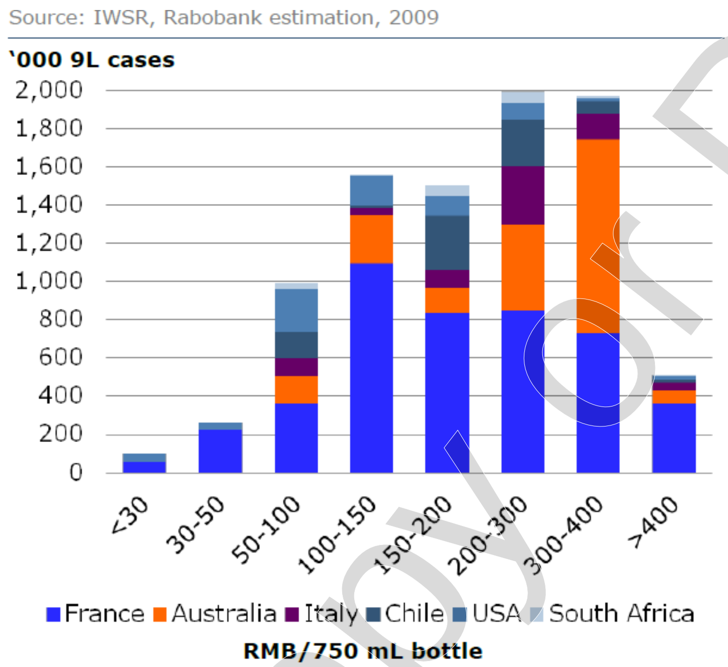

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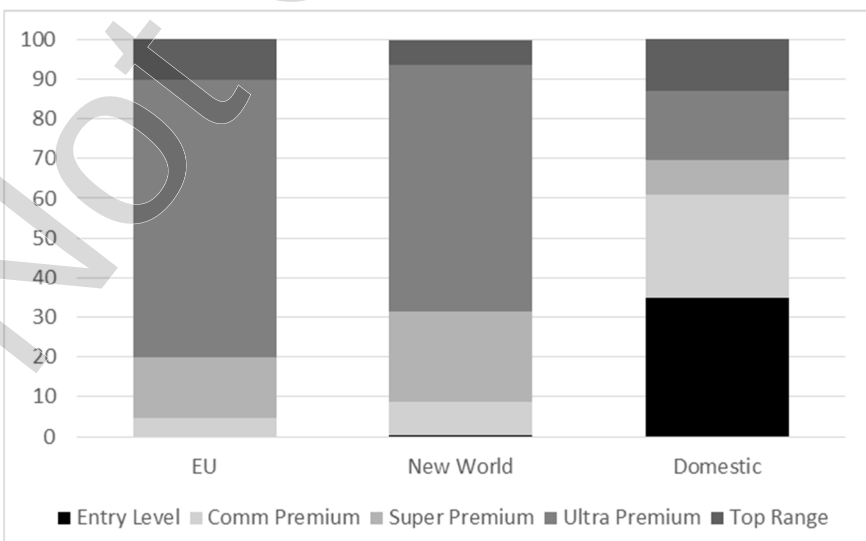
Exhibit 9b Bottle Wine Positioning in China by Price Segment and Area of Origin (%), 2014



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