



## **GLOBAL, LOCAL OR SEMI-GLOBAL? THE CASE OF THE WINE INDUSTRY**

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## ABSTRACT

In this study we analyze the extent of globalization in the worldwide wine industry. Using the framework developed by Yip (1989) for analyzing industry globalization potential, we conclude that the industry does not appear to be amenable to globalization on the supply and demand side. This study provides corroborating evidence for semiglobalization and additional support for the somewhat neglected notion that location-specificity matters. We argue that the wine industry represents an extreme case of such location-specificity – not only at the level of a country, but, on the supply side, even at a much lower level of a particular region or ‘terroir’. We also find that global wine firms are aggressively driving the integration of cross-border markets, rather than passively responding to external market imperfections.

## INTRODUCTION

The issue of whether and how firms and industries should globalize has long captured the attention of academics, consultants and business practitioners. Despite the long-standing interest to the phenomenon, our understanding of globalization is far from complete. Two prominent international business scholars, Rugman and Verbeke (2004: 3), for example, assert that globalization is a “poorly understood phenomenon” and, more emphatically, that “globalization is a myth, it never happened” (Rugman, 2000:11). Others have argued that differences across markets have all but disappeared. Theodore Levitt (1983), the most ardent proponent of this perspective, to whom we owe the beginning of the debate on globalization in international management, claimed that, because of globalization, a global strategy for a company is not a choice but a necessity. Still others have a more balanced perspective on globalization and its strategic implications. For example, Farrell (2004) urges managers to have a deeper understanding of the global industry and of a firm’s full globalization potential to reduce costs and generate new revenues in international markets.

Whether or not industries can be globalized raises two important issues for academics and practitioners: what (or who) makes an industry global and what strategies should industry participants adopt to address the challenges of globalization. One industry that has been rapidly globalizing and consolidating in the early 2000s is the wine industry. Unlike semiconductors, pharmaceuticals, soft drinks or telecommunications equipment, which are conventionally thought as ‘global’ industries, until the last decade the industry has been predominantly local. Since the late 1980s, however, the share of wine production that is traded internationally has almost doubled and there has been a surge of foreign direct investment (FDI). The industry has started rapid consolidation via domestic and cross-border mergers and acquisitions (Roberto, 2003; Anderson, 2004), resulting in the emergence of global wine firms. Our long-standing interest to the industry has been fuelled by the recent critically acclaimed documentary *Mondovino* where the wine industry is used to explore, in a subtle yet provocative way, the impact of globalization on the lives of ordinary people.

In this article we seek to provide answers to the following questions: To what extent is the wine industry truly global? Is the industry amenable to globalization? What or who is driving its globalization? What are the implications of the industry’s globalization for firms’ strategies? The results of the study are expected to contribute to academics and practitioners having a more informed understanding of the general nature of globalization and its implications.

The paper is structured in two parts. The first part outlines a conceptual framework, with some attention to methodological issues. In the second part we analyze the industry’s globalization potential on the supply and demand side and the role of MNEs in globalization. Brief concluding remarks and practical implications follow.

## THEORETICAL BACKGROUND AND METHOD

Three recent studies in the field of international business and strategic management – by Ghemawat (2003a, 2003b) and Rugman and Verbeke (2004) – are particularly insightful in understanding industry globalization and its firm-level consequences. As Ghemawat (2003a, 2003b) has shown, there is no empirical evidence for what is commonly referred to as ‘globalization’, in the sense of complete integration of product and factor markets. Therefore, it is more useful to conceive of the current state of cross-border integration as ‘semiglobalization’ characterized by residual barriers to integration. Semiglobalization requires a change in thinking about firms and industries for scholars and practitioners, but there are at least three benefits to such change. Firstly, the notion of semiglobalization encourages a relatively stable attitude to the environment of cross-border operations. This is because semiglobalization is going to persist for some time to come: neither the differences between countries are likely to disappear soon, nor the cross-border linkages will build up speedily. Secondly, semiglobalization calls attention to the critical role of location in international business strategy. Thirdly, it highlights the scope for firm strategies that strive to capitalize on the residual barriers to cross-border integration as well as those that try to cope with these barriers.

Rugman and Verbeke’s (2004) study complements Ghemawat’s perspective with strategic analysis. Unlike Ghemawat, who adopts the macroeconomic perspective, Rugman and Verbeke use firm-level evidence on the distribution of revenues of the largest multinational enterprises from the Fortune 500 list. The conclusion, however, is similar – very few multinational enterprises (MNEs) are able to achieve a balanced geographical distribution of sales across the triad regions of the world (the U.S., the EU and Japan). The nine truly global MNEs identified by the researchers are IBM, Sony, Philips, Nokia, Intel, Canon, Coca-Cola, Flextronics and LVMH. One finding, which is important in the context of this paper, is that various parts of the firm’s value chain are affected by globalization to varying degrees. The upstream part of the value chain tends to be more ‘globalized’ than the downstream part. This argument is consistent with Porter’s (1986) study into patterns of international competition. Global competition is more common in industries where upstream activities (e.g., technology development and operations) are critical to competitive advantage. Conversely, downstream activities (e.g., marketing and distribution) are largely country-specific. Therefore, if these activities are critical to competitive advantage, then a multidomestic pattern of competition is more common.

In an earlier study, Bryan, Fraser, Oppenheim and Rall (1999) provide additional evidence on the incomplete integration of markets. Using a sample of twenty five firms in various industries, they find that the global ‘law of one price’ applies to less than 20 per cent of the world’s output. Different industries appear to be located at varying stages of globalization: some remain locally defined (e.g., national defence, construction materials, retail property, food and television production); while others are nationally defined (e.g., beer, shoes, luxury goods, pharmaceuticals, investment banking and professional financial services). In general, only one third of the world’s economic activity seems to take place in global industries, such as petroleum, mineral ores, timber, consumer electronics, aircraft engines and automobiles.

Semiglobalization raises the issue of the role of cross-border activities of MNEs – that is, whether they should be regarded as substitutes or drivers of market integration. In mainstream theories of foreign direct investment (FDI) (e.g., Buckley and Casson, 1976; Rugman, 1981; Caves, 1982) MNEs are seen primarily as a response to imperfections in the goods or factor markets that they overcome by internalizing activities within the boundaries of the firm. Ghemawat (2003b), however, argues that, given the importance of intra-firm trade and FDI, MNEs should also be seen as global connectors responsible for cross-border integration. In a similar vein, Bryan et al. (1999) regard international firms as accelerators of the pace of economic cross-border integration, while Kogut (1999: 6) describes MNEs as “superhighways” bridging the world together.

Informed by these recent theoretical contributions in order to answer our research questions, in this study we adopt the industry globalization framework by Yip (2003). We chose this framework in preference to Ghemawat's (2003b) economic framework, because the unit of analysis in our study is the industry, rather than the economy at large. Yip's framework incorporates four external drivers of globalization – cost, market, government and competitive drivers. The economic framework uses trade flows, FDI and price integration to operationalize product market integration, and capital flows, labor mobility and knowledge (patents, licensing, R&D and productivity spillovers) to measure factor market integration. While non-economic criteria in Yip's industry globalization framework – such as buyer behavior, structure of distribution channels and the nature of marketing – are less readily quantifiable, they cover other relevant industry conditions. These non-economic criteria are also extensively discussed in Porter's (1986) pioneering work on the role of industry conditions in setting a firm's international strategy.

Globalization at the level of the individual firm is operationalized in terms of the breadth and depth of penetration of foreign markets and measured using Rugman and Verbeke's (2004) classification scheme. Home-region oriented are those firms that have at least 50% of their sales in their home region of the triad markets. Bi-regional MNEs have at least 20% of their sales in each of two regions, but less than 50% in any one region. *Host-region oriented* are firms having more than 50% of their sales in a triad market other than their home region. *Global* firms have sales of 20% or more in each of the three parts of the triad, but less than 50% in any one region of the triad.

## THE 'GLOBAL' WINE INDUSTRY?

### Industry background

The wine industry is markedly different from other food and alcoholic beverages industries – while these industries are limited only by market, the wine industry is somewhat limited by the resource (land and grapes). This is because wine can only be grown in moderate climates and on certain types of soil (Anderson et al., 2001). Some of the best wines in the world are produced on sites that have scarcity value in the sense that they are unique, non-expandable and non-replaceable. Like any agricultural product, wine is subject to the vagaries of weather and disease, which may create substantial fluctuations in yearly supply of grapes.

On the producer side, the worldwide industry is highly fragmented, with over a million wine companies around the world and none of the firms controlling more than 1% of retail sales, with the top 10 players commanding 11 per cent of global market share (based on volume). This stands in stark contrast with the beer and spirits companies, where the top 10 players command 45 and 23 per cent of market share, respectively<sup>1</sup>. Industry concentration, however, differs substantially by country. The Old World countries (e.g., France, Italy, Spain, Portugal and Germany) continue to be highly fragmented. France, for example, has some 230,000 producers, and in Bordeaux alone there are over 12,000 producers. By contrast, the industry in New World countries (Argentina, Australia, Chile, New Zealand, South Africa and the U.S.) is highly concentrated: in Australia, four companies capture over 80 percent of the market<sup>2</sup>; in the U.S., the five biggest producers until recently had 62% of the market<sup>3</sup>, while in Chile the top five producers command 50%. In addition to concentration, buyer power, barriers to entry, substitution, supplier power and intensity of rivalry explain the differences in industry structures (Roberto, 2003). On average, the industries in New World countries appear to be more structurally attractive than in Old World countries.

In the last decade the industry structure has been undergoing dramatic change. One of the most pervasive trends is the consolidation of wine suppliers. This consolidation is driven by a range of factors, including the capital-intensive nature of the industry and hence the need to achieve economies of scale, a consolidating retail base, an increased interest in branded wines from both consumers and retailers, the threat of a global wine surplus which could put a pressure on margins, and the fear by the New World producers of the EU's retaliation. The acquisitions of Beringer (U.S.) by Foster's Group (Australia), of Seagram's assets (Canada) by Diageo (U.K.) and Pernod Ricard (France), of Montana (New Zealand) and Mumm Nuvee Napa (U.S.) by Allied Domecq, and the merger of Southcorp with Rosemount (both from Australia) are early signs of industry consolidation. Roberto (2003) suggests that in addition to the economic (profit-maximizing) rationale, other reasons not consistent with shareholder value creation are driving the consolidation trend. More specifically, cash-flow rich alcoholic beverages companies (e.g., Allied Domecq, Diageo and Foster's) appear to be cross-subsidising investments in pursuit of growth in the premium wine industry, because their own markets (spirits and beer) are maturing.

On the consumer side, the worldwide market for wine is estimated at over \$US100 billion (2003/2004). Three import markets are critical to the success of wine companies: Continental Europe, the U.K. and the U.S. These markets are the largest, the most profitable, and have the most sophisticated and affluent consumers. The Asian markets are also growing in importance, but they constitute only 4 per cent of the total world consumption (Findlay, Farrell, Chen and Wang, 2004).

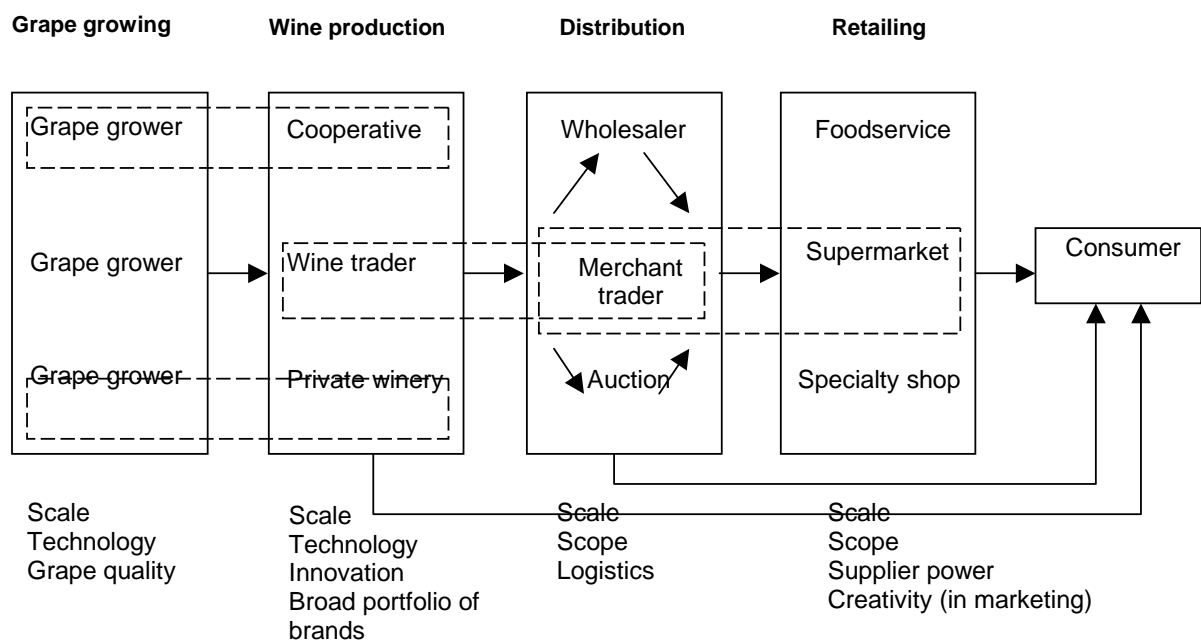
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1. Source: Goldman Sachs JBWeere.
  2. On 17 of January 2005 Foster's launched a AU\$ 2.5 billion bid for Southcorp, which would have created the largest wine company in the world to rival Constellation/Hardy. If the offer is eventually accepted, this will make the Australian industry even more concentrated.
  3. In December 2004 Constellation/Hardy (the largest wine company in the world) acquired Robert Mondavi, one of the largest US firms, which makes the U.S. industry more concentrated.

Two factors are believed crucial to competitive success in the wine industry: differentiation of the product offering and access to distribution. In the struggle to differentiate their products, wine producers have adopted two main approaches: labelling by region and branding (Rachman, 1999). It is unclear which approach is proving to be more successful or profitable. On the one hand, labelling by region has the advantage of imparting the sense of place and even mystique. Branded wine, on the other hand, is a starting point for inexperienced consumers and has the prospect of creating customer loyalty and, therefore, higher sales volumes and profit margins. Access to distribution is a significant entry barrier in most international markets which many wine firms try to overcome via mergers and acquisitions.

### Industry globalization potential

A useful starting point in the analysis of industry globalization is the disaggregation of the industry value chain into upstream and downstream activities (Porter, 1986) and identification of competitive advantages at each stage of the value chain. The industry value chain is presented in Figure 1. Three sources of competitive advantages, or value chain economies, are pertinent in a global industry – scale, scope and learning (Kogut, 1985; Ghoshal, 1987). When these economies exist, industries are global in the sense that firms must compete in the world markets to survive (Kogut, 1985). Other advantages – logistics, grape quality and brand portfolio – are critical in the wine industry regardless of the geographical scope of competition. Note that scale in grape growing and wine production can be offset by product differentiation: for example, the producer of the ‘cult’ red wine Henschke’s Hill of Grace (Australia), crushes well below 1,000 tonnes of grapes per year, while Orlando Wyndham crushes 200,000 tonnes.

Fig. 1 – The industry value chain and competitive advantages



Source: Based on Bartlett (2003)

## Supply side: Cost drivers

Cost globalization drivers include global scale economies, favorable logistics, differences in country costs, steep experience curve effects, high product development costs and fast-changing technology (Yip, 2003). The first three factors appear to have a far broader effect in the wine industry than the last three<sup>4</sup>. Generally, high manufacturing economies of scale in an industry encourage global market expansion, globally standardized products and globally centralized production. Grape growing and wine making account for approximately 40 per cent of the global average cost of a bottle of wine (Anderson et al., 2001). It is believed that scale and scope economies in a local wine industry exist in centralized bottling and packaging (Roberto, 2003). Whether they do in grape growing and direct production is, most likely, determined by the history, the structure of the industry and technology in a particular country. The Australian industry, for example, is amenable to economies of scale and scope in growing and production. Most of the grapes are planted on large flat lands which are easy to cultivate, and the vineyard ownership is heavily concentrated in the hands of large multi-brand wine (Southcorp and Hardy Wines) and alcoholic beverages companies (Foster's / BBWE and Pernod Ricard / Orlando Wyndham). These companies are able to centralize production in a single, very large facility (BBWE's winery in the Barossa Valley, South Australia, is an example). By contrast, in most of the EU the industry is dominated by very small producer cooperatives, which makes reaping economies of scale and scope problematic. One of the reasons is history: over many centuries, small agricultural holdings were continually fragmented as land was parceled out by rulers, taken through war or broken up through inheritance (Bartlett, 2003). Overall, though, global (as opposed to national) economies of scale in the wine industry do not apply, as they do, for example, in the consumer electronics industry. Although the minimum efficiency scale for a winery to be profitable is likely to differ across countries, single-country markets are large enough for producers to achieve optimum scale.

Transportation costs are a significant cost component<sup>5</sup>. Raw material inputs (grapes and grape must) are expensive to transport, which explains why grape growing and wine production are usually co-located. International trade is economically justifiable only in certain wine categories (i.e., those with high value added relative to the overall cost of the product), while the transportation of low value-added wines (e.g., 'vins de table' or jug wines) is uneconomical<sup>6</sup>.

Factor costs, such as the cost of land, geography and climate, knowledge infrastructure, availability of capital and labor, differ significantly among countries, providing a strong incentive for wine companies to arbitrage these differences (see, for example, Rabobank Wine Industry Report, 1999). Global competitors can locate

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4. There is no empirical evidence of the steep learning effects; the product development costs are not high in the wine industry, and the technology of wine production did not change in any radical sense since the earliest times. Technology is very important for wine quality, but it can hardly be described as 'fast-changing'.
  5. Transportation costs, together with wholesale/retail margins, account for 37 per cent of the global average cost of a bottle of wine (Anderson, 2001).
  6. In their modelling of the world wine market, Wittwer et al. (2001) assume that transport costs for imported wine are 15 per cent for super premium, 25 per cent for premium and 30 per cent for non-premium wine.

various activities in the value chain across countries / regions and reap economies of specialization. In addition to achieving efficiencies in current operations, wine companies can also manage risks (e.g., those arising from uncertainties of a vintage in the home market) and benefit from innovation and learning opportunities (e.g., learning from differences in managerial processes or wine-making techniques) (see Ghoshal, 1987).

### Supply side: Competitive drivers

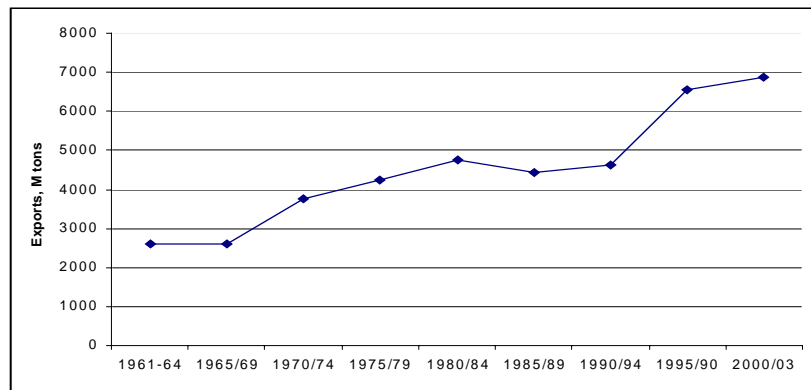
Competitive globalization drivers include a high proportion of exports and imports, competitors from different continents, interdependence of countries, globalized competitors and transferable competitive advantage (Yip, 2003). One of the most basic and easily quantifiable competitive drivers is the high level of exports of wine, which may drive the competitors to adopt a global strategy (Figure 2).

International wine trade, despite falling per capital wine consumption, accounts for one quarter of the volume and an even higher share of the value of global wine production. The greater part of the trade, however, is represented by short-haul trading within the EU. The volume of long-distance international trade is much less considerable, although of relatively high value being mainly fine wines and the preserve of vintage. On balance, while trade intensity has increased, there are still significant barriers to complete integration.

The largest competitors in the worldwide industry (see Appendix 1) come from different continents and countries. As a case in point, the dominance of the EU – which accounts for 60% of world production and 80% of world trade – is being challenged by the New World producers. Large competitors, particularly alcoholic beverages companies with wine interests, see themselves as competing not only on a regional, but, increasingly, on a global basis: for example, Diageo benchmarks its performance against Allied Domecq, Pernod-Ricard, Bacardi and Brown Forman and aggressively pursues the strategy of global product standardization (it owns five out of ten global brands in the spirits segment of the industry, but none of these are wine brands).

Competitive advantages in the wine industry on the supply side are difficult to transfer, because they are primarily location-specific and immobile (see Porter, 1998). They are based on an array of linked industries, including suppliers of specialised inputs (e.g., grape stock, irrigation technologies, wine-making equipment), buyers, and governments and institutions (e.g., research and training facilities). Economies of scale in grape-growing and wine-making are only partially internationally transferable via exporting. Generally, scale economies in production, as Caves (1982: 95) notes, have the “least affinity” with FDI: they induce firms to centralize production and export, rather than decentralize production and undertake FDI. Technology transfer is contingent on the similarity of wine-making techniques: for example, it is arguable whether there are many benefits in transferring technology from New World countries, based on economies of scale in the upstream part of the value chain, to Old World countries, where these activities are less scale-intensive. In summary, it appears that while wine is becoming a much more internationally traded product, the other competitive globalization drivers work against the integration potential of the wine industry.

Fig. 2 – Volume of wine exports, 1961-2003



Source: *Global Wine Production, Consumption and Trade. Statistical Compendium*

### Demand side: Market drivers

The market drivers favoring globalization depend on buyer behavior and the structure of distribution channels. If end customers in different countries want essentially the same type of product or service (or can be so persuaded), opportunities for producers arise to market a standardized product with minimal local adaptation (Yip, 2003), thus achieving economies of scale and scope across the value chain. The potential for standardisation differs significantly across the two wine segments – (1) the so-called ‘industrial wines’, based on the identification of the country of origin in support of the brand, and (2) premium, regionally differentiated, ‘terroir’ driven wines (Croser, 2004). The two segments are characterized by different underlying technological characteristics (i.e., different viticultural and wine-making processes) and consumer behavior.

Industrial wines are consistent, standardized and homogenised – in effect, commodities, often sold in supermarkets and likened to Coca-Cola. Standardization is possible, and cost savings are achievable, but consumers’ willingness to pay for a less differentiated wine is concomitantly reduced. Although wine companies have not traditionally relied on advertising<sup>7</sup>, in more recent years several premium wine firms have begun aggressive brand-building on radio and TV, creating a potential for scale and scope economies (Roberto, 2003). Gallo, for example, spent \$30 million on promotions and advertising in the U.K. over a seven-year period. The second type of wine is better quality, differentiated, usually blended and often site identified, supported by the artisan winemaker and his / her techniques. Some famous denominations, such as Château Mouton-Rothschild in the Bordeaux region, also carry a brand name. This segment is highly profitable. Marketing to this segment is heavily reliant on channel promotion and image of ‘haughty elitism’. It is argued that these two segments are incompatible – in the sense that it is not possible to take a commodity brand and also earn for it sustainable credibility for the production of regionally differentiated wines – and that these incompatibilities are increasing with

7. Advertising may be difficult to justify in terms of return on investment, particularly if the brand is small or sold locally or regionally.

consumer awareness (Croser, 2004).

Standardization, it would seem, is only possible in the industrial wine segment, but there is an important caveat. As consumers become more educated about wines and / or more affluent, they tend to shift away from commodities in search for superior, more varied wines. Complex economic modelling of the world wine market predicts that producer prices for super premium (i.e., regionally differentiated premium) wines are likely to increase (Wittwer et al., 2001), reflecting consumers' higher willingness to pay. Empirical evidence strongly indicates (e.g., Schamel, 2000) that there is an increasing preference for heterogeneity on the demand side, which works against product standardization.

Further barriers to globalization are the parochialism of consumers in wine-producing countries and family, social or religious traditions. For example, both in France and Australia imports command less than 5% of the market. In Germany, imported wines are well represented in the lower end of the market, but under-represented in the premium segment, with less than 5% of wines imported (Heijbroek, 2003). Many European families continue to produce their own wines for domestic consumption (Roberto, 2003), with wine-making techniques handed down in generations, and it is unlikely that this tradition will change in the near future. Islamic traditions in the affluent Middle Eastern countries prohibit alcohol consumption. Consumer tastes also seem to differ: for example, Chinese elite consumers exhibit preferences to sweeter wines and dilute ultra-premium wines with soft drinks (Anderson, 2004).

Distribution channels – more specifically, their structures, level of concentration and relative importance of store formats – exhibit considerable cross-country differences. In the U.S., the top five distributors (Southern Wines & Spirits, Charmer / Sunbelt, National Distributing Co., Young's market and Glazer's Wholesale) command over 33% of the wholesale market (Roberto, 2003). Even though they carry a portfolio of imported wines, they serve their national market and have no international operations of any significance. These distributors have, at best, reached the status of 'national global customers' (Yip, 2003: 36) – that is, they search the world for suppliers, but the purchased product is used only in one country.

Wine retailing in the U.S. is also concentrated, with top five retailers commanding approximately 30% of the market (Heijbroek, 2003). Costco, the largest wine retailer in the U.S. and 11th largest retailer in the world, operates an extensive network of membership warehouses in 37 states and seven countries. It does not have a significant international presence, though, with only 17% of sales and 20% of assets located offshore in 2004. Wal-Mart, the largest retailer in the world, has modest international presence – its international sales constitute less than 10% of total sales, and its international operations are confined to the North American market.

Wine distribution in Europe is dominated by large alcoholic beverage firms – Diageo, Anheuser-Busch (AB), LVMH, Heineken and Allied Domecq. Of these, only LVMH is a truly global firm, Diageo and Allied Domecq are bi-regional firms, and

Heineken is home-region oriented<sup>8</sup>. AB is difficult to categorize due to data non-availability, but it is hardly a global firm<sup>9</sup>. Retailing channels in Europe differ in terms of their concentration: the top five retailers in France and Germany, two largest wine markets, control about 65% of the distribution. Retail formats also differ: in Germany, for example, discount retailers dominate wine sales (approximately 45%), while in the U.K. retail chains have the largest share of the off-trade segment (75%) (Heijbroek, 2003). Some of the world leaders in world supermarket sales (they also dominate wine sales) include Carrefour and Intermarché (France), Metro AG and Aldi (Germany), Ahold (Holland), Sainsbury, Tesco and Marks & Spencer (U.K.). Rugman and Girod's (2003) study of 49 largest retail MNEs shows that most of those firms are either home-market based or operate, at best, in neighbouring countries, and most of the European retailers have nearly all the business in the E.U.

Clearly, the varying structures of wholesale and retail distribution channels across countries and lack of global scope act as a major impediment to standardization and global branding. In fact, global wholesale channels of distribution are rare in any industry, and the same conclusion applies to retailing.

Transferability of marketing (brand names, promotional strategies and pricing) in the worldwide wine industry is limited. A case in point is that the wine industry does not, in effect, have global brands (regardless of what senior executives often claim about their companies having global brands). The exceptions are high-end champagnes, such as Veuve Clicquot and Moët et Chandon (both by LVMH), but this segment represents a small share of the total wine market. Although in some markets, particularly in the U.S., U.K. and Australia, powerful brands do exist, they are not readily transferable to foreign markets: for example, Jacob's Creek (Orlando Wyndham), the top selling wine in the U.K., did not have much success in penetrating the U.S. Chile's Concha y Torro is highly successful in the U.S., but is much less popular in Europe and hardly known in Australia.

To conclude, the structures of specific country markets in the wine industry on the demand side differ significantly (some of these differences are summarized in Table 1) and, therefore, do not appear conducive to creating economies of scale and scope. In other words, the economics on the demand side do not point to many advantages in integrating activities on a global basis.

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8. 73% of Heineken's sales are in Europe, 14.2% in Americas, and only 4.4% in Asia-Pacific (2003 Annual report).

9. AB is a diversified firm, but beer represents its major business segment. International beer operations account for only 5.8% of the firm's total beer sales (10-K report, 2003, note 15).

**Table 1 – Buyer behavior and distribution channels for wine in Australia, Italy, the U.K. and the U.S**

	<b>Australia</b>	<b>Italy</b>	<b>UK</b>	<b>US</b>
Buyers/ distribution	Licensed liquor stores	Supermarkets dominate (even for appellation wines), traditional shops are losing importance	Few major customers (supermarkets and independents)	Three-tier system (producer, distributor and retailer) which cannot be owned by a single entity
Brands	Market dominated by producer brands	Little consumer branding	Retailers have own brands	Market dominated by producer brands
Styles	Varietal wines	Denominazione (region-based classification)	New blends preferred	Straight varietal wines
Occasion	Becoming part of everyday life	Wide appeal, part of everyday life	N/a	Appeals to a small segment of society (wealthier and higher educated individuals)
Opinion leaders	Multiple (newspapers and magazines, wine books authors, TV presenters)	N/a	Multiple	Two opinions matter: <i>The Wine Spectator</i> and Robert Parker

Source: Combe (1998: 112-113), Roberto (2003) and Corsi, Pomarici and Sardone (2003).

### Regulatory drivers: Impact on the supply and demand side

Government regulation has always played a major role in the wine industry – up until recently, export duties were common. As a matter of historical curiosity, taxes on Bordeaux exports used to be so high in the dark ages that, when they were lowered in 1203, tax revenues actually increased (Anderson et al., 2004). More recently, import tariffs, non-tariff barriers (geographical indication systems, labelling laws and subsidies), preferential market agreements and wine consumption taxes continue to effectively prevent the industry from globalization on both the demand and supply side.

Tariffs have traditionally been the most important barrier to world wine trade (Foster and Spencer, 2002). Some governments impose unusually high tariffs on wine imports – China’s tariffs are yet to come down from 65 to 10% (in 2006), while India’s tariffs continue to be very high, at 166% (down from 200% in 2003). Overall, though, tariffs have been reducing (following the WTO Uruguay Round), which put a greater pressure on major producing countries (particularly the EU) to rely on various non-tariff trade barriers. Arcane labelling laws in Japan, which allow imported wines to be blended with local wines and sold as a ‘Product of Japan’, are in effect protecting the local producer with an inferior value proposition (Anderson, 2004). Another example is the domestically administered geographical indications (GI) system that most major wine producing countries have. The system in France, Switzerland, Italy, Portugal, Spain and Greece is highly prescriptive (Foster and Spencer, 2002) and incorporates a tightly regimented series of laws and regulations that describe the steps that must be followed from the moment of vine planting through to the bottling, labelling and selling of wines. The French GI system (which

includes Appellation d'Origine Contrôlée and Vin Délimité de Qualité Supérieure) has perhaps the strictest guidelines requiring the producer to indicate vineyard location, variety, growing technique, crop yield, grape ripeness, alcohol content and wine-making practices.

Changes to regulation in the Old World markets represent a major threat for New World producers. After successfully securing protection for geographical indication, such as champagne, sherry and port, the EU proposed a new regulation that demands recognition for 'traditional expressions', such as tawny, ruby, vintage, classic and cream, to be useable only on EU wines sold in the EU<sup>10</sup>. Heavy subsidization of wine production and exports in the EU is yet another impediment to globalization of the wine industry. Recent government subsidies in EU countries aimed at helping wine producers upgrade their industries are estimated at \$1.35 billion per year (Anderson, 2003).

Wine consumption taxes in many of the non-producing countries (e.g., Scandinavia) continue to be high, and state monopolies that control the production, wholesaling and distribution of alcoholic beverages effectively discourage consumption (Foster and Spencer, 2002). Finally, a large part of world trade in wine takes place under various forms of preferential arrangements – the EU, the NAFTA, the MAA and Mercosur are some examples.

In summary, this empirical evidence leads us to four conclusions: (1) there are significant barriers to the globalization of the wine industry; (2) there is a strong location effect of value-adding activities across the industry value chain; (3) the industry appears to be an essentially domestic industry on both the demand and supply sides; and, more controversially, (4) it does not seem amenable to globalization to start with. These findings raise the question of the role of MNEs in globalizing the domestic industry and the appropriate firm-level strategies.

### The role and strategies of MNEs

In so far as the international wine markets are less than perfectly integrated, what is the role of MNEs in shaping these markets? It has been suggested that MNEs, including wine firms, somehow passively respond to the forces of globalization. Yet one most single important industry trend is that of industry consolidation, via domestic and cross-border mergers (see Table 2) despite the fact that, judging by the growing volume of trade (refer back to Figure 1), external markets are becoming more efficient. An important feature of this trend is the increasing magnitude of the deals and the premia paid<sup>11</sup>. The globalizing wine industry and the competitive behavior of its participants give weight to the notion that there is some merit in viewing MNEs as aggressive drivers of global integration, rather than passive 'victims' (Rugman, 1982: 51) of external market imperfections. Arguably, MNEs force the globalization of what we have shown to be a collection of local industries.

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10. The EU amended the regulation in 2004 to allow 'traditional expressions' to be used to describe wines from countries outside Europe.

11. Premia for premium wine companies may range from 10 to 17 EBITDA.

In theory (see Ghemawat, 2003b), managers of international firms in industries characterized by incomplete integration (i.e., semiglobalization), have a spectrum of strategic opportunities at their disposal, to create value from their international strategies. These opportunities range from localization ('one country' approach) to standardization ('one world' approach). In view of the strong location effect in the wine industry, the strategic opportunities available to firms should be closer to the localization side of the spectrum. In other words, firms should exploit differences across markets and reap economies of specialization via arbitrage, manifested as either advantages in absolute costs or buyers' willingness-to-pay. Arbitraging capitalizes on cross-border differences in products, the cost of capital, labor or knowledge by geographically separating activities in an integrated vertical chain<sup>12</sup>. Arbitraging via trade has been the original international strategy for many firms, and wine firms are no exception. International wine trade began in the 1300s, initially to relatively short distances within Europe and then, in the mid 19th century, with improved bottling and packaging technologies, to longer distances (Anderson, Norman and Wittner, 2004).

By contrast, aggregation is based on the exploitation of similarities across countries to realize economies of scale, scope or learning. Aggregators take advantage of locationally mobile resources to perform the same activities in different countries. Due to data limitations because of reporting standards, we cannot establish with confidence whether the strategies of the largest firms in the wine industry – such as Constellation, LVMH and Allied Domecq – are geared to arbitrage, aggregation or both<sup>13</sup>. However, judging by explicit statements of strategy by senior executives, we tentatively conclude that the logic of value adding seems to have shifted from arbitrage to aggregation.

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12. Arbitraging (exploitation of differences) should not be confused with local responsiveness, which requires the firm to forgo the benefits of integration because of the requirements to tailor its activities to host country conditions (see Rugman and Verbeke, 1992: 770, Note 2).

13. Arbitraging can be measured as a percentage of export sales to total sales; aggregation can be measured using the ratio of foreign sales or assets. The largest wine firms are diversified and do not report the international sales, assets and exports for the wine segment separately.

**Table 2 - Recent cross-border M&As in the wine industry, 2000-2004**

Acquiror	Year	Target	Consideration
Allied Domecq (UK)	2001	G.H. Mumm & Cie and Champagne Perrier Jouet (France)	€75 M
	2001	Montana Group (NZ)	NZ\$1B
	2001	Buena Vista Winery (US)	US\$85.5M
	2001	Bodegas y Vinedos and Vinedos y Bodegas (Argentina)	US\$42.9M
	2002	Bodegas y Bebidas S.A. (Spain)	€279.2M
	2004	Gray Farrell (US)	N/a
Diageo (UK)	2001	Seagram, 62% (with Pernod Ricard)	£3.7B
	2004	Chalone Wine Group (US)	US\$260M
Constellation (US)	2003/4	BRL Hardy (Australia)	US\$1.14B
	2004	Ruffino (Italy)	US\$80M
	2004	Robert Mondavi	US\$1.36B
Foster's (Australia)	2000	Windsor Vyneards (US)	AU\$50M
	2000	Beringer Blass Wine Estates (US)	AU\$2.6B
	2000	Castello di Gabbiano (Italy)	AU\$35M
	2001	Matua Wines, 51% (NZ)	AU\$9.3M
	2001	Etude (US)	N/a
	2001	International Wine Accessories (US)	AU\$35M
Pernod Ricard (France)	2001	Seagram, 38% (with Diageo)	£1.9B

**Source: Company reports**

To conclude this section, it would be worthwhile to speculate for how long the industry will remain imperfectly integrated and what implications it might have for firm-level strategies. Research by McKinsey & Co. (Bryan et al., 1999) shows differential patterns of globalization in various industries: it took 20 years for the bond market to globalize, Coca-Cola achieved globalization of the soft drinks industry in 50 years, personal computers globalized in 10 years, and the beer industry (the industry perhaps closest to wine), which started globalization in the 1980s, is yet to achieve the global status in approximately 15 years. Another study by A.T. Kearney (Deans, 2003)<sup>14</sup> suggests that all industries undergo a series of stages – from the initial stage, where industry participants have low concentration ratios, to the final stage, where concentration ratios are as high as 90% (the defense, tobacco, shoes and soft drinks industries are at this stage). The pattern, according to these estimates, spans about 25 years for any industry. If these predictions are correct<sup>15</sup>, then semiglobalization will characterize the wine industry for at least two decades and will shape the scope of firm strategies. Until then, both New World and Old World small exporters will, most likely, continue to capitalize on the residual barriers to cross-border integration via arbitrage, large multinational industry consolidators will try to cope with these barriers via aggregation and others will try to exploit both aggregation and arbitrage opportunities.

14. This study analyzed 1,345 M&As by 945 acquiring companies over ten years.

15. A.T. Kearney's research strongly suggests inevitability of industry globalization and seems to be based on the belief that all M&As succeed, which is, of course, an overly optimistic view of merger outcomes.

## CONCLUSIONS AND IMPLICATIONS

In this article we analyzed the globalization potential of the wine industry and reached the conclusion that the industry can be characterized as incompletely integrated. Moreover, it does not appear to be amenable to globalization on the supply and demand side. This study thus provides corroborating evidence for the proposition of the incomplete integration of cross-border markets and additional support for the somewhat neglected notion that location matters. The wine industry, it would appear, represents a somewhat extreme case of such location-specificity – not only at the level of a country, but, on the supply side, even at a much lower level of a particular region or ‘terroir’. We also tentatively propose that what we are witnessing is a forced globalization of an essentially local industry.

On the practical side, we sense some fascination with the ‘globalization’ of the industry via FDI and cross-border mergers and acquisitions, particularly from senior executives of large alcoholic beverages firms. A harsher look at the industry structure suggests that the economic drivers are working largely against such globalization. If the seduction of the idea of globalization prevails over economic reasoning, it is worth remembering that the ultimate test is not whether an industry can be globalized, but whether this can be done profitably. Hence, a careful blend of aggregation and arbitraging strategies capitalizing on the similarities and more so on differences across markets may prove more viable than the aggressive pursuit of scale, scope and learning via aggregation.

## Appendix 1: Global orientations of major wine companies' using Rugman and Verbeke's (2004) classification schema

Company	Home Region	Sales, US\$, 2003/2004	FSTS	North America % of TS	Europe % of TS	Asia-Pacific % of TS	Orientation
Constellation / Hardy (US/Australia)	North America	2396 (wine only)	38.6%	61.4%	31.9%	6.7%	Home Region Oriented
E&J Gallo (US)	North America	1357	N/a				N/a, possibly Home Region Oriented
Allied Domecq (UK)	Europe	1200	58.0%	43.1%	42.0%	N/a	Bi-regional
LVMH (France)	Europe	1140	82.0%	26.0%	38.0%	29.0%	Global
Southcorp (Australia)	Asia-Pacific	1050	60.0%	34.8%	25.2%	40.0%	Global
Foster's/BBWE (Australia)	Asia-Pacific	1050	36.1%	19.9%	9.5%	70.6%	Home Region Oriented
Diageo (M pounds) (UK)	Europe	8891	84.1%	30.4%	44.1%	11.2%	Bi-regional
Castel Frères (France)	Europe	666	N/a	N/a	N/a	N/a	N/a
Freixenet Yvon Mau (Spain / France)	Europe	528	N/a	N/a	N/a	N/a	N/a
The Wine Group (US)	North America	500E	N/a	N/a	N/a	N/a	N/a
Pernod Ricard (France)	Europe	440	83.0%	22.5%	56.8%		Home Region Oriented

Source: Various industry sources, annual reports and 10-K reports. The ranking is based on Heijbroek (2003).

### Abbreviations:

FSTS – the ratio of foreign sales to total sales

TS – total sales

Data are for the most recent year (2003/4) and are collected from annual reports and 10-K forms. Robert Mondavi is not included, as it is now part of Constellation.

N/a – data are not available, because these firms are privately owned.

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