

# Industry analysis report the australian wine industry



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## INDUSTRY ANALYSIS REPORT THE AUSTRALIAN WINE INDUSTRY ' The

Boutique Producer' by 4 students (anonymous) Executive Summary This

report provides an overview of the Australian Wine Industry using Porter's

Five Forces industry analysis framework and seeks to provide

recommendations based on the impact of the forces for a start up boutique

producer. Through the use of Porter's framework and the application of

economic theory, the report will provide detailed insight into the drivers of

each force and the pressures that these forces put on the industry.

These insights will then be used to determine the competitiveness of the

industry and formulate recommendations for a start up boutique producer.

Methodology The report initially provides a market definition to contextualise

the analysis before focusing in on the particular forces within the framework

and presenting their impacts independently relative to a start up boutique

winery. The analysis of this framework provides a dynamic picture of the

industry and at the present time. Finally this report provides clear,

substantiated recommendations for a start up boutique winery that are

supported by both framework analysis and economic theory.

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is the 6th largest producer globally and comprises roughly 2000 wine

companies, employs an estimated 31,000 people, and generated a turnover of \$3 billion in 2007 (AWBC, 2008).

In the Australian industry a winery is generally considered boutique when it produces an average of \$75,000 per year (Edwards et al, 1990; Johnson, 2003). These factors combine to make the boutique consumer inelastic and more brand loyal relative to other segments (refer to Table 1). They do however expect consistent quality and consider products to be socially representative. Table 1. Demand Elasticity for Alcohol

Price Income Advertising Beer 0.360.3940.02 Wine 0.71.10.007 Spirits 0.6710.07 Alcohol 0.4970.4990.032 Men 0.5090.193 Women 0.750.12 (Gallet, 2007)

The Retailer The cost structure of boutique wineries requires product to be sold from a minimum price point of \$15, under this price competition is difficult (WFA, 2007). Boutique retailers, such as restaurants, however have a markup anywhere between 50% - 70% (WFA, 2007). Therefore, a \$15 bottle can be sold for \$22, greatly increasing potential elasticity whilst banding off product demand to the boutique consumer, or at best the 'experimental consumer' (Johnson, 2003) whom may only consider the product at this price when bundled with cuisine. Cellar Doors

Also article Purely Monopolistic Seller,

Cellar doors create an environment for the consumer of exclusivity and allow boutique producers to increase price due to the value add of the experience.

The value add of the experience also helps to improve demand through

bundling by capturing market segments that would not traditionally  
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purchase wines at this price point. Often particular varieties of wine are only sold through cellar doors. This further reinforces the environment of exclusivity and limited availability. Boutique wineries focus on targeted distribution and sales such as cellar doors and restaurants rather than compete for shelf space with the big wholesalers.

This is to the advantage of final consumers, as retail buyers develop a strong relationship with a favoured producer, either through consumption or sales, which in turn encourages successive vintage purchases. Suppliers Inputs For a boutique producer inputs primarily consist of Agricultural requirements, for example land and processing infrastructure, as well as general operational and distribution activity points i. e. Cellar Doors. Agricultural Activities - Land Land is a crucial input to a start up boutique winery, and as previously discussed can also provide a significant barrier to entry.

From the supplier perspective, the bargaining power of the purchaser is highly dependant on the present market rates as well as current government restrictions on the use of land and the subsequent availability of licenses . The availability and location to prime market areas and geographic resources (such as water supply) drive the market elasticity demand factors governing land price. As such, site selection, soil profile and climate , all critical to wine flavor and quality, will (thanks to geographical experience indicators (AWBC, 2008)) significantly drive up the cost of land and determine the product that can be grown.

General Agricultural Activities Agricultural equipment to support vineyard activities is supplied by a number of monopolistic suppliers. These suppliers

compete across various agricultural sectors and as such stock specific, yet substitutable products that allow the purchaser some level of freedom in choice of supplier. This condition subsequently increases the ease of substitution (Porter, 1980). Vines Due to the potential destruction of grape vine roots by a small bug (phylloxera), many local Australian councils place restrictions on the importation of grape vines into grape growing areas.

This has the affect in turn of minimizing the amount of differentiation available for a small start up boutique and may diminish an immediate competitive advantage. Wine Processing Bottling Bottles, Caps and labels are available from multiple suppliers. In NSW alone there are nine different suppliers (WD, 2008). These suppliers however can achieve a dominant position when producers purchase particular shaped bottles or labels to increase differentiation and brand recognition. This reduces substitutability, increase dependence and strengthens the suppliers power (Porter, 1980).

This situation is further emphasized by the oligopolistic market structure of specific wine suppliers for example chemical, preservative and oak cask suppliers and the producer's need to maintain product consistency. Boutique wineries generally contract out bottling services to a small number of available bottlers. This in turn creates an oligopolistic environment that can leave producers potentially vulnerable. Labour Vineyard labour can be split into two functional groups, each of which has varying levels of affect on producers. The first group is qualified professionals in winemaking, agriculture, marketing and business management.

This labour group has the greatest ability to exert pressure on producers operations due to their direct role in vineyard functions. On the other hand, the second group, commonly available manual labour, has little or no power over operations. This condition however has begun to shift, in the Hunter Region, with manual labour increasingly attracted to the mining industry by stronger wages. Internal Rivalry Regional, state and national wine shows allow firms to compete at various levels to achieve industry based awards that bolster product recognition.

This in turn has a direct positive impact on sales as it shifts the demand curve to the right whilst simultaneously increasing inelasticity. For a small start up boutique winery, such awards can elevate a company rapidly to success and market expansion. Within the wine industry a strong comradery and bond exists between most wine makers regardless of size. This relationship encourages information sharing which has the affect of intensifying fierce rivalries, particularly between regional wine growing areas within the country.

In establishing regions, for example Glenn Innes, small boutique growers need to align their business activities with complimentary industries such as art & crafts, restaurants and gardens to establish a regional attraction. This allows boutique growers to leverage significant tourism traffic and quickens the growth of brand competition between cellar doors. Government The role of the government in the Australian wine industry is multi faceted, with several bodies providing various levels of support across the industry.

A handful of the key support organisations and their roles are briefly discussed below. - Australian Wine and Brandy Corporation (AWBC) Assists wineries with strategic support in export regulation, compliance and marketing, and provides data and analysis for the industry. AWBC is also funded by wine sector levies. (AWBC, 2008) - NSW Department State and Regional Development Board (DSRD) Provides investment services for the industry and is responsible for regional tourism, export assistance and industry development.

DSRD is appointed and governed by the NSW government (DSRD, 2008) - Department of Primary Industry Assists in and enforces regulation of the agricultural components of the wine industry such as vermin and animal Control, general weed and pest eradication (DPI, 2008) -Australian Government Protection Agencies (EPA) Provides guidelines and enforces legislative requirements, whilst offering assistance and guidance with environmental planning and approval processes in conjunction with the state and local governments. EPA, 2008) Recommendations Based on the pressures exerted by the forces on the Australian wine Industry as discussed in this report, the following recommendations are made: -1) Investment in a start up boutique winery is recommended if the investor(s) intends to consolidate the sunk cost of establishment through personal existence (e. g. live on the winery/property, adopt the lifestyle). This would then allow for the estimated 3 year establishment period to pass and for the vintage to develop. 2) Investment in a start up boutique winery is not recommended if the investor(s) are seeking purely economic going concern. This is primarily due to the lag in ROI which as identified throughout this report can be

affected by many variables, either from within the industry, or environment.

-3) Developed (or established and developing) boutique wineries should consider, in conjunction with the various government supported bodies, the growth potential of export markets, particularly China and India and their ability to tailor product styles to appeal to these markets (ie sweeter brands for China).

The drive behind this recommendation however would not be sufficient to encourage a start up venture. -4) Start up ventures should consider the possibility of technology improvement and how this may help overcome some of the barrier discussed throughout the report. For example the development of drought and salt tolerant grape varieties to combat climate change. Further, start up ventures need to strongly consider site selection opportunities and identify potential areas prone to future water shortages.

## Conclusions

This report provided an analysis of the Australian Wine Industry and presented recommendations for a start up boutique winery based on substantial industry insight and theoretical application. It should be noted however that the framework of forces used to determine recommendations are dynamic and consistently shifting, and as such the analysis presented is a snapshot of the industry at during one period. From the analysis risks in the industry are potentially foreseeable, both in the medium to long term, primarily around the impact of the environment, increasing domestic production

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