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Article

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Future opportunities and challenges for the South Australian wine industry: An interview with John Angove

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John Angove is the Managing Director of Angove Family Winemakers. He has worked in the family company for more than 40 years and is a fourth generation grape grower and winemaker. He became Managing Director in 1983 and Chairman in 2001. John was appointed as a Member of the Order of Australia in 2011 for service to the wine industry.

1. The South Australian wine industry: the current situation

The South Australian grape growing and wine making industry is a key part of the State's economy and one of the very few agricultural industries in Australia that significantly adds value to its raw material, wine grapes. As such it is very important that the future for the industry is strong.

It is a regionally based industry and in South Australia employs approximately 11,000 people and in Australia some 28,000 people. You will be familiar with the key SA regions such as the Barossa Valley, McLaren Vale, the Clare Valley, Coonawarra and of course the Riverland. It is interesting to note that the Riverland produces in excess of 50% of the SA grape crush. With the high profile of the recognised regions the importance of the Riverland region in SA and the other inland river regions in NSW and Victoria, to the Australian wine industry is often overlooked, or at least misunderstood.

With an eye to what the industry might look like in 21 years time it is interesting to look at where we have come from in the last 21 years (Figs. 1,2).

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Note the potential for oversupply as compared to the current balanced tonnage of around 1.6 m t. Note also that in excess of 200,000 t is estimated to have been left on the vines in 2010.

The volume is below the peak of 2007, but holding up reasonably. Note the sharp decline in value as more and more export volume occurs in bulk. This conversion to bulk shipments is having a significant impact on bottling activity and employment and has resulted in an excess of bottling capacity in the nation.

Some of this information hints at the state of the industry but does not clearly indicate the very difficult time the wine industry is having at the moment. The primary driver of the current difficulties is the significant oversupply of wine grapes that the industry has been trying to deal with for several years.

2. The interview

2.1. How has this come about?

Through the early to mid-1990s Australian wine was in demand around the world and the wisest industry heads put out a vision in 1996 for the industry called "Strategy 2025". The strategy drew up where the industry could be in the year 2025 and how it could get there. This proffered a very positive future and caused an incredible boom in grape plantings and winery assets across the nation.

We now have one winery for every 8800 population in Australia, in the USA the figure is one winery for every 55,000 population. We are well overpopulated with wineries and will see a decline in their numbers as we progress.

What was supposed to take 30 years to increase the nation's vineyard occurred in less than 6 years. Massive oversupply resulted and continues today.

Very few vineyards in SA are solely dependent on the income from that vineyard for the owner's livelihood.

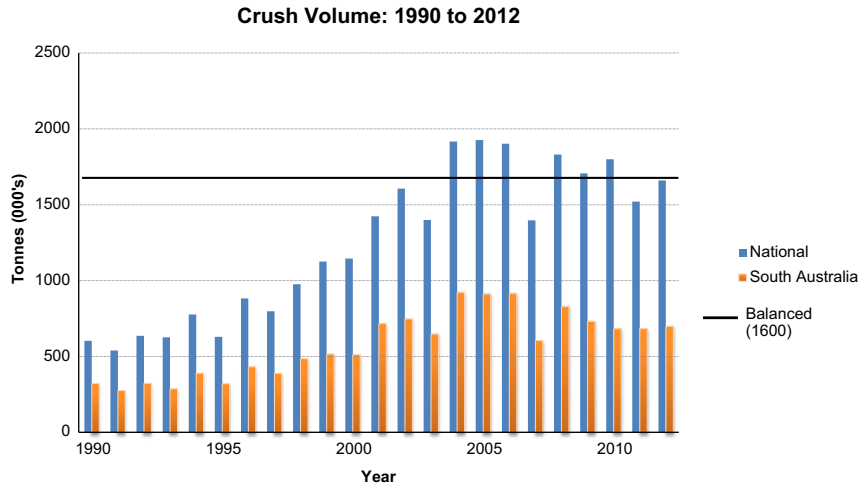


Fig. 1. Tonnage crush Australia and South Australia.

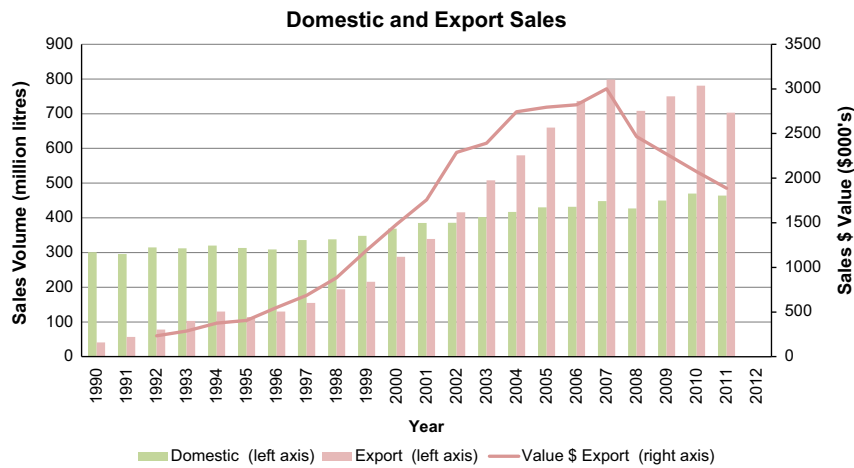


Fig. 2. Wine sales (volume and value) domestic and export for Australia.

An estimated 80% of families or businesses that own vineyards have an alternative source of income, so the economic pressure of the oversupply of grapes is being masked by that alternative income. The flow on from this situation is that readjustment of the grape tonnage is very slow to occur. The nation's vineyards still have the potential to produce up to 1.9 m t in a reasonable year, well in excess of the industry's needs.

I believe that the oversupply of wine grapes is going to be around for a while yet and grape prices will remain depressed. We need to remember that an oversupply of grapes is more the usual condition for the industry across the world.

Other factors that influence the industry over which we do not have great control include the exchange rate, currently causing chaos in the export arena, and driving strong growth in imported wine. The GFC has and continues to dampen demand around the world; the domestic two speed economy has put the average wine consumer under increased financial pressure. Climate change and its related uncertainties, and the uncertainties of government legislation and regulation will always be wild cards in the pack. The industry needs a level of certainty for future planning and at the moment this is hard to find.

2.2. *So what are the things we need to focus on as an industry to see us safely into the next 21 years?*

Top of the list is the quality of our product. Australian wine is rightly considered to be near the best, if not the best, at all price points in the world. That is a sweeping statement but is backed up over and over again by the success our wine has in international wine shows across the globe. In November 2012 Australian wine topped the medal table at the 2012 International Wine and Spirit Competition in London.

2.3. *Why is this so?*

Three reasons:

- (1) We have one of the best winemaker and viticulture training institutions in what was Roseworthy College, which is now the Adelaide University Wine Science Centre.
- (2) We have a spread and diversity of wine growing regions across Australia that is second to none. From the cool southern Tasmania regions to the warmer inland river

regions we have every base covered. We are also blessed with viticultural regions that mostly have low disease risk profiles allowing reduced technical intervention in grape growing. In fact the Riverland district right here in SA is possibly the lowest risk area in the world, and organic grape growing has an enormous opportunity in the region.

- (3) The industry owned Australian Wine Research Institute in Adelaide is the premier wine research centre in the world. From its founding over 50 years ago it has been the primary driver of Australia's superior wine quality. Research is a critical component of the industry, and equally important is the highly developed extension and adoption process, so the results of the research are made as accessible to industry as possible.

These three aspects have created an innovative and progressive wine and grape growing industry that is prepared to experiment, try new things, and lead the world in innovation. It is imperative that these resources continue to be nurtured and funded, or we will see our competitive advantage diminish.

Here are a couple of examples of industry innovation: the bag in box wine package, first in the world, was developed in South Australia. The first successful use of screw caps on premium wine, occurred in SA, in the Clare Valley, and how quickly that has spread across the world to the detriment of the cork industry. It is absolutely paramount that the industry continues to fund its R&D arm.

After quality of product I think marketing is next on the list. We can never take our position in the wine world for granted; we have to be out there all the time telling our consumers and potential consumers all about us and how good we are.

Wine is an unusual product in that its provenance is so important. Australian wine will only ever be able to be made in Australia; McLaren Vale Shiraz will only ever be able to be made from grapes grown in McLaren Vale. Clare Valley Riesling will only ever be made out of Clare Valley Riesling. The recent Government zoning legislation proposed to protect McLaren Vale and the Barossa Valley from the inevitable suburban creep is an important step in the longer term vision for the industry.

After quality and marketing comes representation. I am a great believer in the very simple philosophy that you buy things from people and companies that you like. The representation of our product is vital so that we get as many people out there liking us as possible. As the Chairman of a family company I may be a bit biased, but I believe the family structure and appropriate family commitment to the business, is a truly wonderful way to have the company 'represented'. The passion and commitment exuded by family members as they traverse the world has to be seen to be believed and in Australia there are lots of family wine companies so in all we can make a significant impact.

We have seen corporatisation of many old family names, Seppelt, Hardy, Lindeman's, Gramps Orlando, Wolf Blass, Mildara, Rosemount, Penfolds, the list goes on, and broadly

the large corporates have not done well. The wine industry with its high capital intensity, its one production opportunity per year, its high stock holding demands, its agricultural risk and its historically low return on capital investment, is not a good formulation for public corporations.

We are seeing a growing interest from China in our vineyards and winery assets, and this could well be a significant factor in the next decades. They take a longer term view on investment than our share market players. In strong contrast is the soft drink industry where the global market is controlled by a handful of companies, and there is no human influence; only mega advertising and promotional budgets to support the brands. I am sure that we do not want to see the wine industry go there.

2.4. Next on the list is tourism

The wine industry offers an enormous opportunity for tourism growth. In SA we have in excess of 378 cellar door outlets across our wine grape growing regions. The leaders are the Barossa/Eden Valley and McLaren Vale. The value to SA of winery tourism is estimated to be in excess of \$500 m per annum. With the large number of small to very small producers, the cellar door is their primary outlet for their products, and with the growing difficulty getting product to the traditional market place, the cellar door and its wine club business is critical to counter the concentration of power in the traditional market place.

Last on the focus list is the nurturing of our export markets. Exports have risen from 12% of total wine sales in 1990 to 65% in 2010. So it is critical to the wellbeing of the industry that exports are sustained. The UK and USA have become our staple markets as exports have surged since the early 1990s, but the next 21 years is more likely to see China and Asia growing to become our prime export destination.

If we are to see China grow there is a real need for government to work more effectively to achieve a Free Trade Agreement between our two countries. Granted it is a complex issue with our wide spread of exports to China, but it is currently an impediment to growth (Fig. 3).

2.5. What are the key risk factors that could upset the industry over the next 21 years?

At the top of my list is the anti-alcohol lobby. In 21 years will wine, beer and spirits be where tobacco is today? There are some out there who would promote this position for the alcoholic beverage industry, and their noise and representation to government is disproportionate to the merit of their message.

I am sure that we can all agree that over indulging in wine, beer or spirits is not smart and the culture of binge drinking is detrimental to the industry and also the imbibers. But to demonise the products for everyone is not the answer. Research indicates that 5% of consumers have problems with their alcohol consumption, 95% do not and are quite comfortable to drink responsibly.

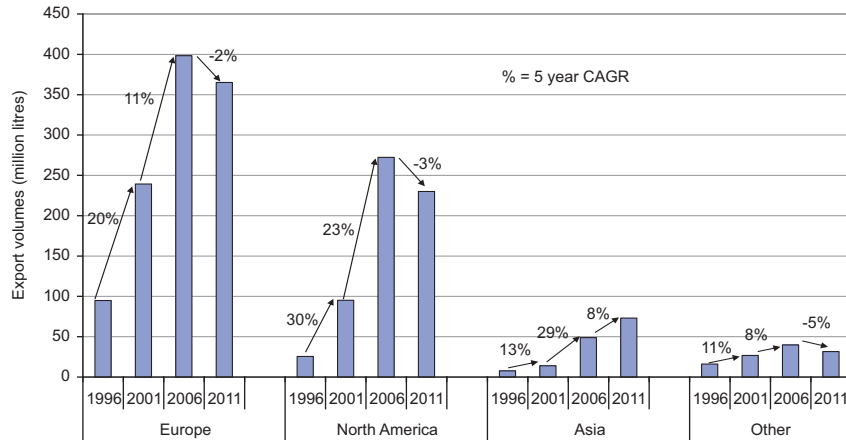


Fig. 3. UK, USA, and Asian growth.

By contrast to the tobacco industry, alcoholic beverages and wine in particular do have health benefits when consumed responsibly. The therapeutic benefits of wine have been known for centuries and much modern research supports what has been instinctively recognised for so long. But like most everything, in excess it has a down side.

Government will respond to the anti-alcohol lobby as we move forward. We already have an enormous amount of ‘guff’ (extraneous information) on our labels to meet statutory requirements, most of which is generally disregarded by the consumer. Standard drinks, preservatives, allergen warnings, alcohol content, pregnancy warnings, and I am sure there is more to come.

It does not hit the newsstands but recent research shows: there is a statistically significant decline in risky drinking from the last survey in 2007 to now. Daily consumers of alcohol have decreased to 7.2% of the population, the lowest figure since the survey began in 1991. Patterns of risky drinking on a single occasion have not increased since the 2007 survey. There is an increase in the number of abstainers under 18 years of age. Fewer women are consuming while pregnant. There is a significant decrease in the number who drove while influenced by alcohol. These are important trends, but they do not hit the airwaves and the anti-alcohol lobby is totally deaf to them.

I foresee a tightening in the ease with which alcoholic beverages can be obtained. Having had general liberalising of access over the last 20 years, this will be reversed over the next several years. Personally, I do not see any reason for access to alcoholic beverages in commercial outlets through to 3 and 4 and 5 o'clock in the morning. It simply encourages the problems that are so obnoxious and anti-social and that we are trying to prevent. It also provides a wonderful source of more fuel to the anti-alcohol lobby.

Before I move off government I should touch on taxation. Australia's taxation of wine beer and spirits is a mixed bag to say the least, but so is alcohol taxation in lots of countries around the world. Recent publicity about taxing wine at the beer or spirits level or to apply a minimum price per standard drink is loud and clamorous,

but has the potential to be seriously destructive for the industry (Table 1).

Note the impact on retail prices of tax at the beer and spirits level, but note also the very significant increase in retail price excluding tax, as the retailer applies his standard margin and GST to the increased tax paid amounts.

The anti-alcohol lobby sees taxation as the easy fix for the issues they constantly raise, but we have seen over and over again that it is not the easy fix they want. A very recent example is surely the large increase in tax on ‘ready to drink’ products. Yes, it curbed the sale of these products, at least temporarily, but increased the sale of spirits and mixers and particularly the sales of alcoholic apple cider, now the lowest taxed sweet alcoholic beverage available on the market.

There are some robust arguments to support the lower taxation of wine as compared to beer and spirits, not the least of which is the agricultural nature of the raw material. Grapes are a long term commitment by the grower and there needs to be a degree of certainty for the investment to be undertaken. Beer and spirits are produced from single year cash crops, so production is more easily able to adjust to changes in demand.

2.6. Is climate change a great risk to the industry over the next 21 years?

I suspect not, but there will be lots more impediments to the use of carbon-based energy. We are all part of an adaptive process, evolution if you like, and we need to expect change and all that comes along with it. How many times have we been told that one thing we can be absolutely sure of is ‘change’, yet when it comes to climate we have this view that we should try to stop or retard change. It is fanciful, we need to be looking as to how we adapt to the changes that we think will come along, for adapt we surely will.

The exchange rate will wax and wane over time and being something over which we have little or no control and even the smartest economists cannot agree on anything except what it is right now, I do not plan to spend any time on it. It certainly has impact on the industry, as we are seeing now, with exports being priced out of some markets or margins being cut to

Table 1
Current and projected impact of tax on alcohol.

	Current WET tax 29%	Volumetric tax at beer rate	Volumetric tax at spirits rate
4 l Soft pack (cask) 10% alc/vol	12.00	35.50	53.95
Tax content per pack incl GST	2.91	21.50	34.96
Price of wine, excluding the tax	9.09	14.00	18.99
Retail price per 750 ml bottle 13.5% alc/vol	10.00	14.75	19.50
Tax content per bottle incl GST	2.37	5.83	9.38
Price of wine, excluding the tax	7.63	8.92	10.12
Retail price per 750 ml bottle 13.5% alc/vol	20.00	22.50	27.50
Tax content per bottle incl GST	4.73	6.55	10.11
Price of wine, excluding the tax	15.27	15.95	17.39

ribbons to retain shelf space, and on the reverse side imports flooding into the country to take up our domestic shelf space.

2.7. So where will we be in 21 years time?

Who knows, but we can perhaps look at the extremes that may exist.

The good picture: supplier of best quality wine to the world. Along with Penfold's Grange and Henschke's Hill of Grace, a string of ultra-premium global brands. Continued recognition of technological excellence through the best R&D, with the AWRI retaining its premier status across the world. Wine retaining its rightful position as a beneficial and socially acceptable beverage of choice. Demand outstripping supply of premium quality grapes from vineyards recognised as the best in the world. A fair and equitable taxation system applied to alcoholic beverages.

The not so good picture: major supplier to Australian wine retailers will be China, good quality, low price, but highly taxed. The retail market exclusively the domain of the two major retailers with their private and control brands only on the shelves, sourced from the cheapest suppliers across the globe. Wine taxation has reduced the size of the Australian industry to a quarter of what it is today. Wine labels are no more than health warnings. Restaurants will have wine/alcohol free sections for diners. Inland river regions will not have vineyards at all, their product having been priced out of the market by taxation and removed from the shelf by health risk scare tactics.

Where will we be? Somewhere between these two options. As I read somewhere recently, from one of our esteemed wine writers, "It is best to ride the waves than to try to predict the currents and the winds". Or in other words "work with what you know and what you can see, if you spend too much time trying to predict the unpredictable you will come unstuck"!