Microeconomics of Competitiveness

The South African Wine Cluster

Neil Davidson| Fayelle Ouane | Christine Phillpotts | Aduke Thelwell | Eric Tung

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COUNTRY ANALYSIS

Overview Of South Africa

Geography

Located on the southernmost tip of Africa along the Cape Sea shipping route, South Africa's history has been shaped by struggles to control its mineral abundance and agriculturally fertile lands. South Africa totally engulfs its two enclaves, Lesotho and Swaziland, and is bordered by poorer neighbors Namibia, Botswana, Zimbabwe, and Mozambique (CIA World Factbook, 2009).

History

South Africa has a burdensome history of social inequality and conflict, rooted in colonialism, apartheid policies of racial separatism, and post-apartheid political corruption. In particular, the apartheid system of legal racial segregation destroyed social and economic value for over 34 years. By the late 1980s, international outrage at discriminatory apartheid policies led South Africa to be placed under economic sanctions by the US, UK and 23 other nations; in many countries, companies and politicians also began divestment from South African business interests. This restricted the availability of certain imports in South Africa and led to a diversification of productive activity, as small local suppliers developed across a range of sectors. Since apartheid ended in 1994, South Africa has rapidly reentered the world community, joining the WTO in 1995, and becoming a member of the UN Security Council (CIA World Factbook, 2009).

Politics

This history has left South Africa the world's 10th most unequal country by Gini coefficient measure (UNDP, 2008), and attempts to reduce inequality through redistributive policies continue to drive South Africa's social and political agenda. Since emerging from apartheid under the leadership of Nelson Mandela, South Africa recently concluded its fourth democratic election, and a 1997 constitution created new and well-developed political and legal institutions. Post-apartheid government has been characterized by high perceptions of corruption and a focus on increasing the economic opportunities available for blacks through affirmative action policies known as Black Economic Empowerment.

Population and Social Conditions

Of South Africa's 48.7 million population, 50% live below the poverty line and 21.7% are unemployed. With 14% illiteracy and a persistent brain drain of tertiary graduates, education begs improvement. The prevalence of HIV/AIDS in 21.5% of the adult population has also created social problems related to child orphans and family disruption (CIA World Factbook, 2009).

NATIONAL ECONOMIC PERFORMANCE

Recent Economic Growth

South Africa is the largest economy in Africa with total GDP at $280 billion in 2007, well ahead of oil-rich Nigeria at $166 billion (Economist, 2009). It is the 2nd wealthiest country in Africa, behind Botswana, with a per capita income of $10,400, and is much wealthier than its neighbors. The average Sub-Saharan African (SSA) country has a per capita income of $2,800, roughly one-quarter that of South Africa's (EIU, 2009). When compared to BRIC countries, South Africa has roughly the same GDP per capita as Brazil ($10,300), but is poorer than Russia ($15,900) and richer than India ($2,900) and China ($6,100) (EIU, 2009).

South Africa grew at about the same rate as its neighbors in SSA between 2001 and 2008. It demonstrated solid and consistent growth, averaging 4.1% per year versus 4.8% and 2.1% for SSA and OECD countries, respectively. South Africa has also improved its export performance, increasing its share of world exports from 0.38% in 2000 to 0.50% in 2007 (EIU, 2009).

South Africa's performance, however, appears less robust when compared to that of BRIC countries. Aside from Brazil, which grew slower than South Africa at 3.6% between 2001 and 2008, China, India and Russia all grew faster at 10.2%, 7.5% and 6.5% respectively (EIU, 2009).

Drivers of South African Economic Growth

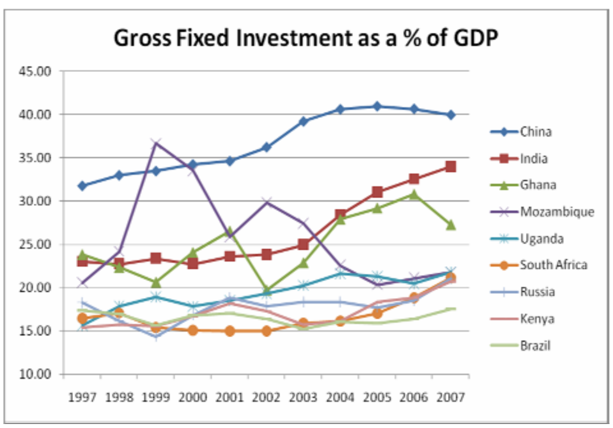
South Africa's post-apartheid growth can be separated into three phases. The **first phase** took place during the end of apartheid when the impact of the sanctions and the instability resulting from the end of apartheid led to a decrease in GDP in 1992 and anemic growth in 1993. The **second phase** took place between 1994 and 2000, when Mandela became president and adopted a strategy of economic liberalization. Government reduced tariffs from 27.5% in 1990 to 7% in 1997, relaxed foreign exchange controls, and reduced government spending as a percent of GDP from 20.2% in 1992 to 18.3% in 1995 (Werker, 2007). Aside from a slight decrease in GDP in 1998 resulting from the Asian Financial crisis, the economy demonstrated strong and steady growth. The **third phase** started in 2000 when the Central Bank began targeting an inflation rate between 3% and 6%. This policy brought down inflation from 9.2% in 2002 to 4.5% between 2004 and 2006 (EIU, 2009) and South Africa experienced growth, exceeding 6% each year between 2004 and 2007. Admittedly much of that growth is attributable to the increase in global commodity prices.

In 2006, President Mbeki launched the Accelerated and Shared Growth Initiative for South Africa (AsgiSA) with the objective of reducing "unemployment and poverty, while increasing the country's gross domestic product growth rate to a sustainable level of 6% by 2010, through marshalling government and private resources to 'eliminating' constraints." The identified constraints were: the overvaluation and volatility of South Africa's currency, an inadequate national infrastructure, a shortage of skilled labor, barriers to entry, limits to competition and limited new investment opportunities, a cumbersome regulatory environment and deficiencies in state organization, capacity and leadership (AllAfrica.com, 2009). Many of these constraints are in-line with those identified by a team of researchers from Harvard's Center for International Development.

AsgiSA enabled the government to allocate $87 billion to improve infrastructure (AllAfrica.com, 2009), which has proven to be astute given the global economic downturn since the funds also serve as a fiscal stimulus. Less progress has been made on initiatives outside of infrastructure, such as increasing participation in the formal economy.

Challenges facing South Africa's Economy

While South Africa's economy has been performing well, there are indicators that point to weaknesses in the structure of the economy. Inbound foreign direct investment (FDI) as a percentage of GDP is lower than all BRIC countries with inbound FDI hitting zero percent in 2006 (EIU, 2009). South Africa's Gross Fixed Investment as a % of GDP suggests an opportunity to increase domestic investment, although it has been ramping up in recent years. The recent increase may be driven by infrastructure investments related to AsgiSA. Compared against BRIC countries, South Africa's investment rate is lower than China or India, in the same range as Russia and slightly higher than Brazil. Higher domestic investment could provide additional employment for a country with choric underemployment, high unemployment and low labor force participation (Hausmann, 2008).



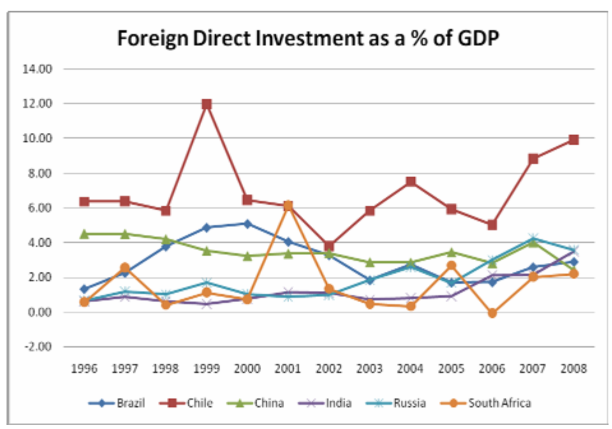
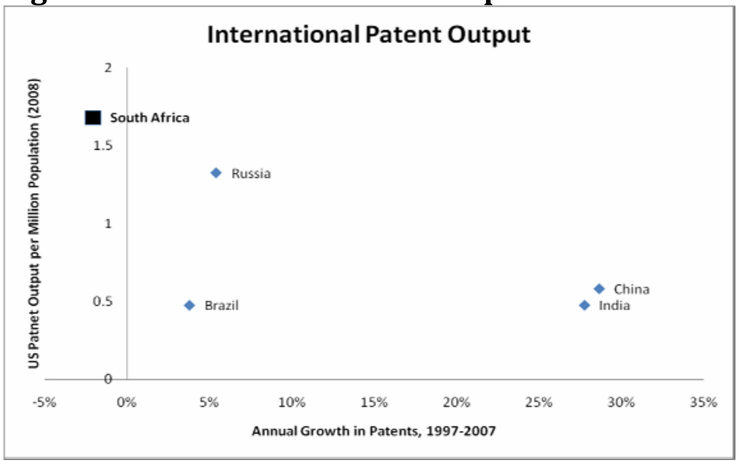


Figure 1a and 1b

Source: EIU 2009

In addition to the lack of foreign and domestic investment, South Africa's patent output is decreasing. While South Africa's patent output per million people is higher than those of all BRIC countries, it is the only country with a negative patent output CAGR.

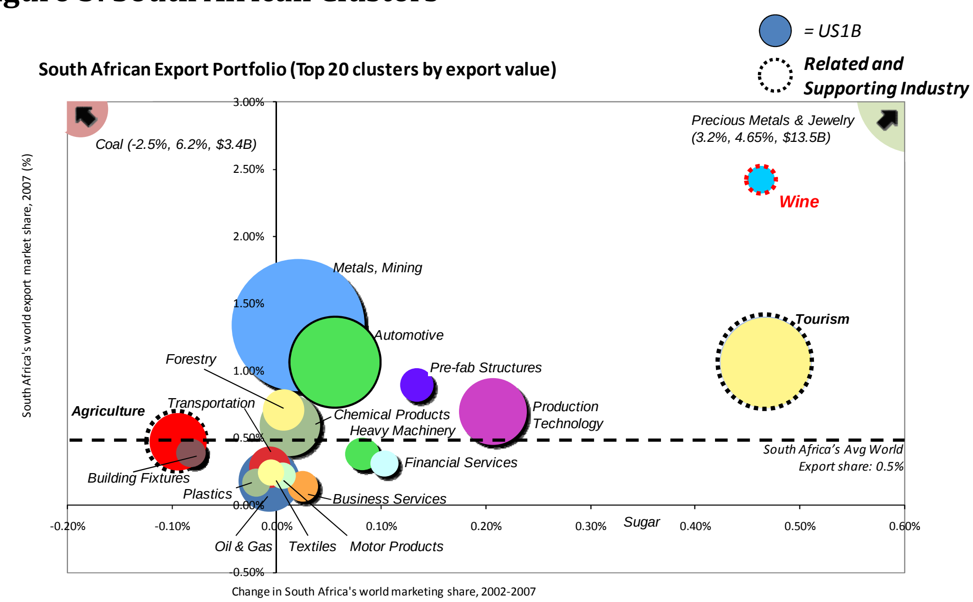
Figure 2: South Africa Patent Output



Source: US Patent and Trade Office, 2008

South Africa's Cluster Map

Figure 3: South African Clusters



Source: ISC, 2009

South Africa's cluster map highlights the breath within the South African economy. Three distinctive features stand out. First, South Africa's economy is highly dependent on natural resources. The country's two largest sectors are Metals & Mining and Precious Metals & Jewelry, which together represent almost 40% of the country's total exports. While both sectors are gaining world market share, especially Precious Metal & Jewelry which gained 3.2 percentage points between 2002 and 2007, they are low value-add industries that involve extraction of the country's natural endowments, which are often exported with minimal processing. Moreover, both industries are highly dependent on world commodity prices.

Second, South Africa has a sizeable manufacturing sector (ISC, 2009). Automotive and Production Technology represent the 4th and 5th largest export sectors in the economy, representing 0.4 and 0.7 percentage points of world export share respectively. Both of these sectors are gaining world market share, which suggests that they are globally competitive. Lastly, South Africa has sizeable related and supporting industries for wine production. Tourism and Agriculture (excluding wine) are the 3rd and 9th largest export sectors in the country. Tourism has demonstrated robust growth, increasing its world market share by 0.5 percentage points between 2002 and 2007. Agriculture, on the other hand, has lost about 0.1 percentage points in global market share over the same time period (ISC, 2009).

South Africa's Economy Going Forward

South Africa's economy will be challenged in the short-term. Commodity exporters will be battered by the global slowdown and related decrease in commodity prices. Long-standing challenges facing the economy, such as brain drain and skills shortages, show no sign of abatement. The government is forecasted to run a budget deficit for the next several years, reversing prior projections for budget surpluses (EIU, 2009). The country continues to have low domestic savings and investment rates while the rand[1] continues to be highly volatile. Macroeconomic tensions are further heightened given the weak social infrastructure. The country's high level of poverty and unemployment will demand government response if the global crisis persists. These challenges are tempered by the country's well-developed financial, legal, energy, industrial production and transport sectors, as well as its ideal location and rich natural endowment.

[1] R8.4 = $1 as of May 8, 2008.

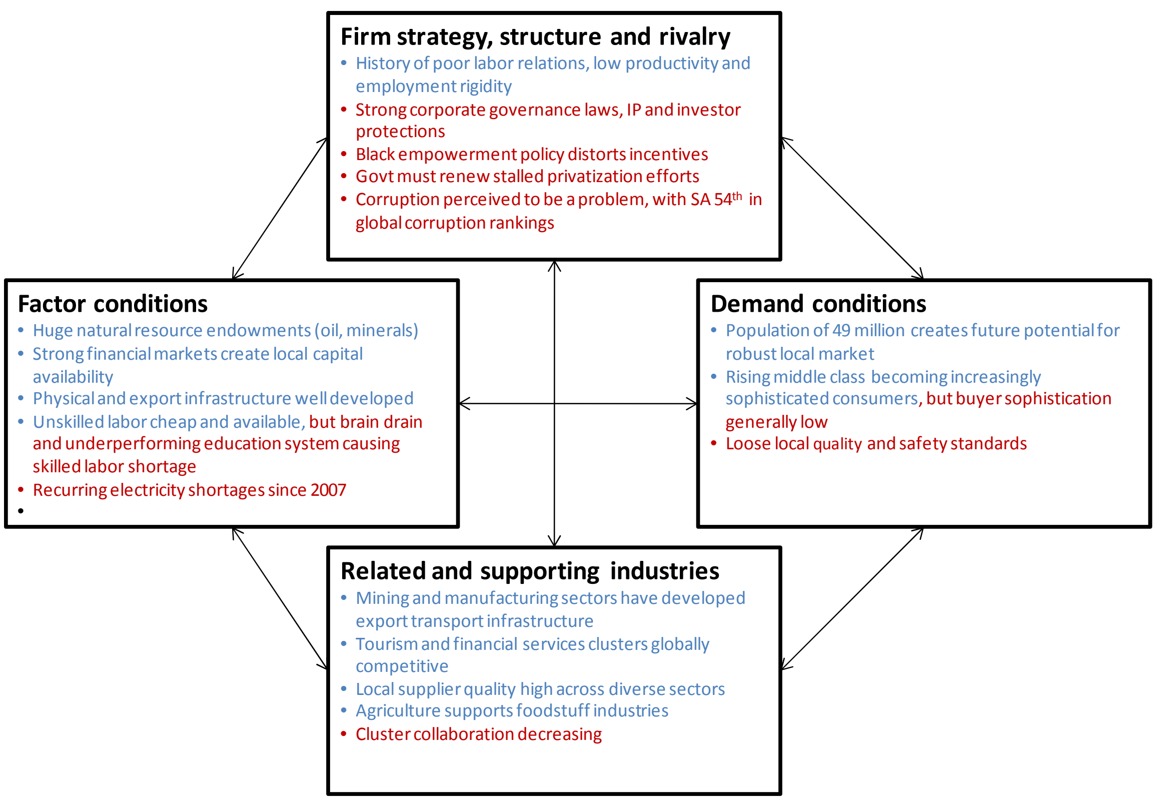
Western Cape

The Western Cape is a relatively prosperous province within South Africa. Although it represents only 10% of the country's population, it generates 14.5% of GDP (SouthAfrica.info, 2008). It is anchored by Cape Town, South Africa's second largest city which is home to many of the country's finance, insurance, real estate, ICT, and publishing companies (SouthAfrica.info, 2008). It is also the country's most popular destination amongst foreign travelers. Moderate climate in the Western Cape's peninsula region provides ideal *terroir* for grape cultivation and fertile soil support agriculture in the southern coastal area. Saldanha, north of Cape Town, is South Africa's only natural harbor, and is used for iron exports and the fishing industry (SouthAfrica.info, 2008).

NATIONAL COMPETITIVENESS: COUNTRY DIAMOND

Country Diamond

Overall, South Africa ranks 51st in global competitiveness of 134 countries (ISC, 2009).



Factor Conditions

South Africa's sophistication in the mining sector has lead to well developed export infrastructure and low factor costs for local manufacturing industries. This, combined with the country's strategic location along international shipping lanes, has led to the development of a sophisticated export infrastructure such as ports, airports and highways. Similarly, strong regulatory frameworks and oversight of the financial sector has given the country a sound banking system and sophisticated local credit markets, despite a low and declining domestic savings rate of 13% which has constrained the availability of growth capital (Dovi, 2008). This strong capital markets infrastructure is one of the country's most competitive sectors, and South Africa has improved it rank from 20^{th} to 13^{th} among 74 countries in the Global Competitiveness Report (ISC, 2009).

On the other hand, South Africa continues to suffer from a shortage of skilled labor and local R&D capacity. This is driven by an underperforming education system, low levels of tertiary enrollment and steady emigration of skilled workers with technical expertise. One consequence of this is that South Africa's patent rate has been steadily declining, falling 25% between 2001 and 2008 (USPTO, 2008). Lastly, electricity shortages and weak transportation infrastructure within the country have hampered efforts to boost economic productivity in rural inland areas.

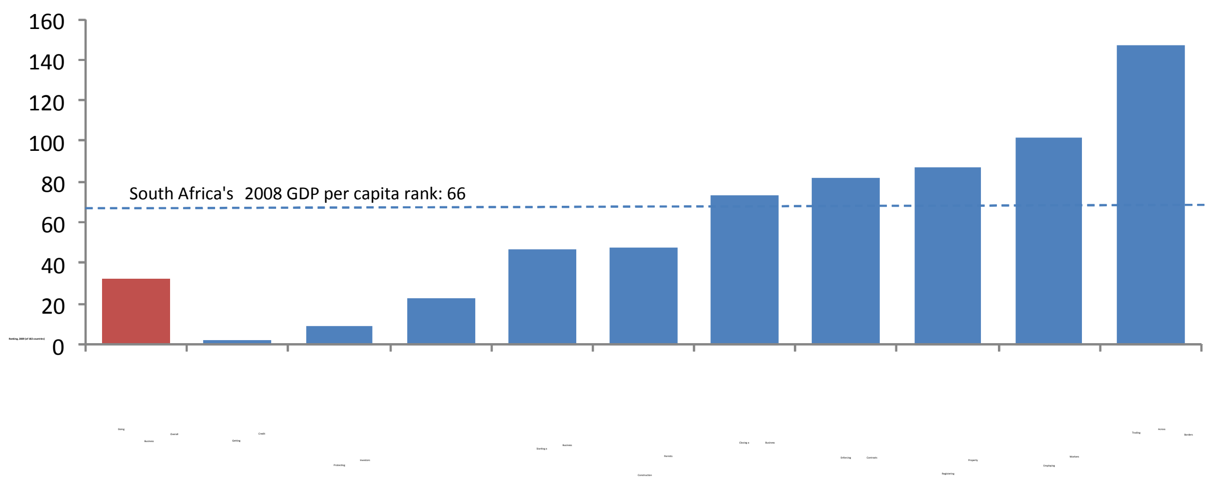
Demand Conditions

Despite high poverty rates, South Africa maintains high buyer sophistication and is ranked 21^{st} among 134 countries. Product and environmental regulatory standards are ranked 40^{th} and 47^{th} internationally, and show significant room for improvement (ISC, 2009).

Firm Strategy, Structure and Rivalry

South Africa's competitive context is largely favorable; as the country enjoys strong corporate governance standards and enforcement of intellectual property standards. This is reflected in the country's high rankings of 9^{th} in strength of investor protection and auditing/reporting standards and 22nd in intellectual property protection versus 134 countries in the Global Competitiveness Report.

Figure 5: Ease of Doing business in South Africa



Source: DoingBusiness 2009, South Africa Report

On the other hand, labor-employer relations in the country rank 119th internationally and the frequency of union-led strikes would make the French blush. Such deep worker antagonism, along with the high employment rigidity caused by restrictive hiring and firing regulations, frustrates efforts to increase worker productivity. Corruption also creates problems for businesses hoping to enforce legal contracts. The largest barriers to competition for South African businesses are cumbersome regulations which make cross-border trade difficult and restrict capital flows (World Bank, 2009).

Related and Supporting Industries

Because of the local necessities created by apartheid-era economic sanctions, South Africa has a well-diversified economy with numerous local suppliers, but poorly developed clusters. Unfortunately, the state of cluster development and extent of collaboration in clusters have fallen 5 and 10 points respectively on global competitiveness rankings since 2001, suggesting a waning commitment to cluster coordination (ISC, 2009).

THE GLOBAL WINE INDUSTRY

282 million hectoliters of wine was produced in 2005, of which 28% was internationally traded (OIV, 2005). Three European countries (France, Germany, and Italy) are the largest producers, making 142 hectoliters combined. United States and Australia compose the second tier, with China, Argentina, and South Africa being the most important third-tier producers. These eight countries account for 76% of global wine production.

On the demand side, the United Kingdom and Germany are the largest importers of wine globally, together accounting for about one-third of internationally traded wine. Spain, France, and to a lesser extent the United States are significant wine consumers but can rely on domestic production to supply a greater fraction of their demand.

The wine trade has changed significantly over the last five years. Volume has been growing at an average of 3.9% per year, and in value terms the growth is an even more dramatic 25% per year (in non-inflation-adjusted terms) (OIV, 2005). France's historically dominant position in exports has been eroding, its market share having fallen by 4%, with smaller gains in market share being realized by a number of countries, including New Zealand, Argentina, Germany, South Africa, and Chile. The average value of wine exported from France ($5.35/liter FOB) is much higher than that from any other country, a lead which has widened over the last five years (FAO, 2009).

THE SOUTH AFRICAN WINE CLUSTER

CLUSTER HISTORY AND EVOLUTION

Established by Dutch settlers in 1659, the South African wine cluster is more than 350 years old but has only recently begun to become internationally competitive.

Factor Conditions Evolution

Jan Van Riebeeck, the first Dutch Commander of the Cape, actively promoted viticulture in the colony and Simon van der Stel, second Cape governor, continued this support. Der Stel focused on improving factor conditions by sharing European wine making best practices with other farmers and using these techniques on his own wine estate. South African wine producers were further exposed to European viticulture in 1688, when the French Huguenots immigrated to the Cape, fleeing religious persecution in France.

In the 20th century, scientific research played an increasingly important role in the development of varietals that became uniquely South African. In 1925, Abraham Perold, the first Viticulture Professor at Stellenbosch University, cross-pollinated Pinot Noir with Hermitage to develop Pinotage, a brand new grape variety. In 1946, Distell, one of the largest South African wine producers, opened the first modern research and quality control center and in 1955, the Viticultural and Oenological Research Institute was founded (NLSA, 2008). New research and technological developments also helped protect local production from diseases. After phylloxera destroyed millions of Cape vines in 1885, phylloxera-resistant rootstocks were grafted onto surviving vines to protect domestic production.

Demand Conditions Evolution

In 1652, the Dutch East India Company set up a refreshment station at the Cape of Good Hope. Although the Dutch historically did not have a strong culture of drinking wine, wine still played an important role in this trade hub as it was traditionally supplied on ships in order to prevent scurvy and other diseases during long sea voyages. The local wine tradition began to grow with the arrival of French settlers in the 1680s.

International demand for most South African wine was minimal, given its poorer quality. Britain's occupation of the Cape in 1806 and its protracted war with France facilitated the entry of South African wine onto the British market. Britain reduced customs duties on Cape wines to a third of that of European producers and by 1822, more than 10% of the wine consumed in Britain was imported from the Cape (NLSA, 2008). During the first half of the 19th century, wine production grew from 0.5 million to 4.5 million liters, largely driven by growth in the British export market (WineNet, 2009). However, the risks of relying too heavily on one export partner were realized in 1861, when Britain lowered import tariffs on French wine after the war, driving a decline in Cape wine exports.

In 1889, the Cape Town Wine and Export Syndicate was created to find new export markets. To further reduce its reliance on a single export market, the cluster also focused on increasing local demand. During the 20th century, private companies and institutions focused on increasing local demand through wine tours, trade shows, and wine courses for the general public. The government also took steps to improve the sophistication and discernment of local demand by instituting the Wine of Origin legislation in 1973. This legislation encouraged consumers to more actively consider wine quality metrics through strict labeling requirements that made origin, vintage, and estate more transparent.

Context for Firm Strategy, Structure and Rivalry Evolution

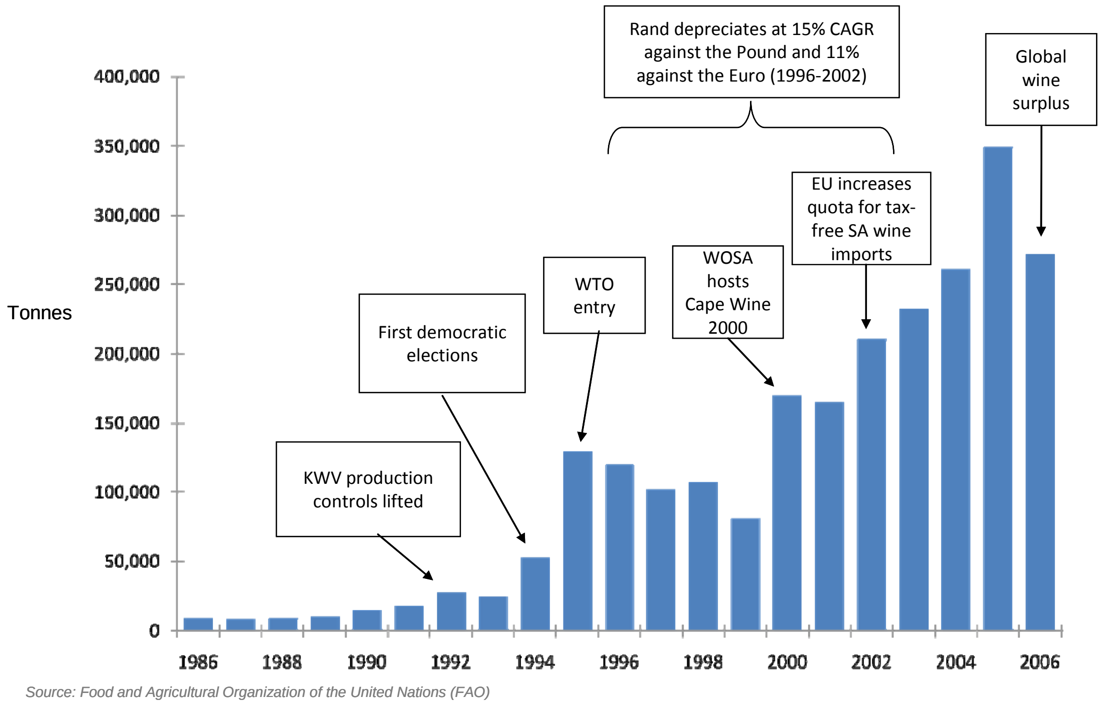
South African wine producers have a history of collaboration, at times leading to protectionist measures that impeded the cluster's global competitiveness. The industry was plagued by overproduction of grapes, leading to the bankruptcy of several growers. In 1918, this led to the creation of the Co-operative Wine Growers' Association (Koöperatieve Wijnbouwers Vereniging van Zuid-Afrika in Afrikaans, or KWV). KWV's stated mission was "to overcome the oppressive constraints of wine surpluses and the exploitation of wine and brandy contractors by improving co-operation and by raising the quality of South African wine and brandy." (KWV, 2009) More than 95% of South African wine producers eventually joined the KWV. (NLSA, 2008) In 1924, the government sanctioned KWV's role with the Wine and Spirit Control Act, which provided KWV the power to set price floors and production quotas. The KWV system was dismantled in the 1990s, with production quota removal in 1992 and KWV's restructuring into a private company in 1997.

The industry was also controlled by large, influential wine producers. Stellenbosch Farmers' Winery (SFW) was founded in 1935 and made its mark on the global stage in 1959 when it launched Lieberstein, the world's highest selling bottled wine in 1964 (NLSA, 2008). Within the past 10 years, a series of recently announced mergers and partnerships have consolidated the industry and further integrated South African wine producers into the global markets. In 2000, SFW and Distillers, two of the largest South African wine producers, merged to form Distell. In 2002, Australian wine producer BRL Hardy announced a joint venture with Stellenbosch Vineyards to produce and market a new South African wine brand in Europe. In 2007, Constellation Brands, the largest wine company in the world, acquired Flagstone Winery, representing one of the largest foreign investments in the South Africa wine industry (Pearce, 2007).

WINE CLUSTER COMPETITIVENESS: CLUSTER EXPORT PERFORMANCE

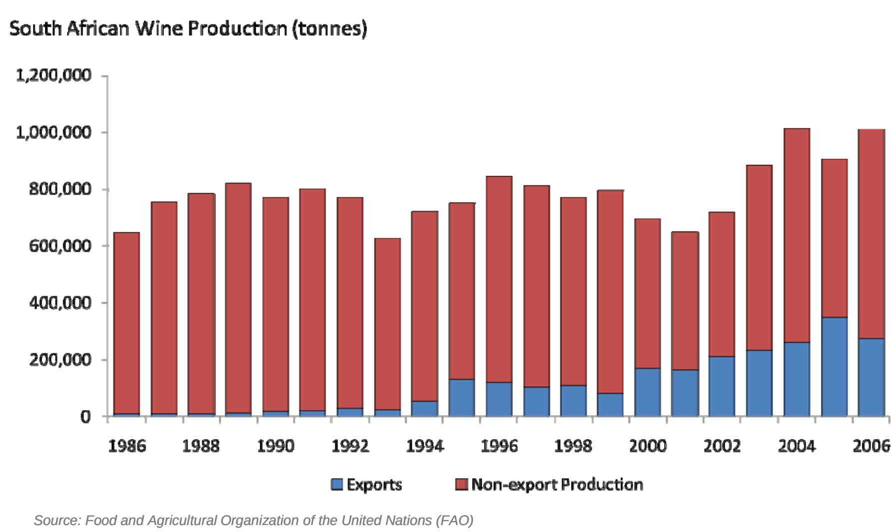
South African wine export volumes have grown at a 19% CAGR from 1986 to 2006, driven by the end of apartheid, industry liberalization, active export promotion, and currency movements. Wine exports have also represented an increasing share of South Africa's total wine production, increasing from 14% in 1996 to 27% in 2006 (see **Figure 8**).

Figure 6: South African Wine Export Volumes



Source: FAO, 2009

Figure 7: South African Wine Domestic Product and Export Volumes



Source: FAO, 2009

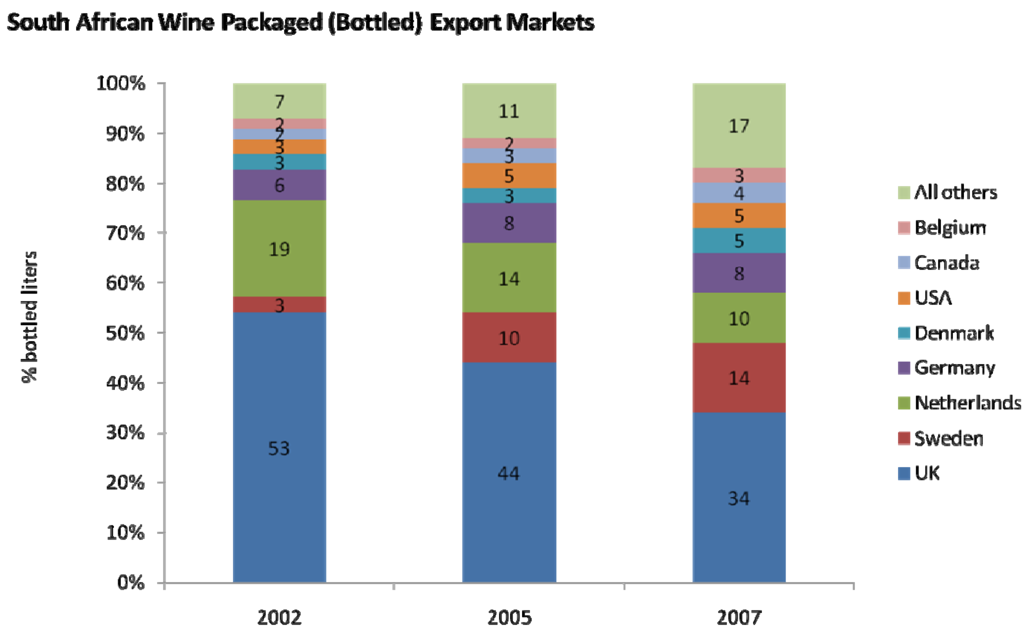
Nelson Mandela's prison release in 1990 and the end of apartheid improved South Africa's ability to export its goods and services. South Africa's re-integration into global trade was marked by the country's entry into the WTO in 1995. These political reforms and trade policy measures led to a 114% and 146% increase in South African wine exports in 1994 and 1995 (FAO, 2009). South Africa's wine industry benefited from further reductions in trade barriers in 2002 with the 10 year EU-SA Wines & Spirits Agreement. This agreement increased the EU's quota for tax-free imports of South African wine by 30%, and allowed a 3% per year increase in the quota (Matthews, 2002). South African wine export volumes increased by 27% in 2002 (FAO, 2009).

South African wine export growth over the past decade has also been driven by active and focused export promotion by various institutions for collaboration. Wines of South Africa (WOSA) has developed marketing strategies to increase international demand and hosted Cape Wine 2000, the first organized trade show of South African wines specifically targeted at international buyers and wine journalists.

South African wine exports are vulnerable to global supply conditions and demand conditions in key export markets, particularly the UK, which remains South Africa's largest export market (see **Figure 8**). According to Yvette van de Merwe, CEO of South African Wine Industry Information and Systems (SAWIS), the 2006 decline in export volumes was driven by lower demand from the UK and the Netherlands (WOSA, 2006). These were South Africa's biggest wine export markets, representing 44% and 14% of exports respectively as of 2005 (see **Figure 8).**

South Africa is slowly diversifying to other export markets. Su Birch, WOSA CEO, views Sweden as a promising growth area (WOSA, 2006). Exports to Sweden have increased from 3% to 14% of total South African wine exports. There is also room for growth in the United States market, which currently only represents 5% of South African wine exports (see **Recommendations**).

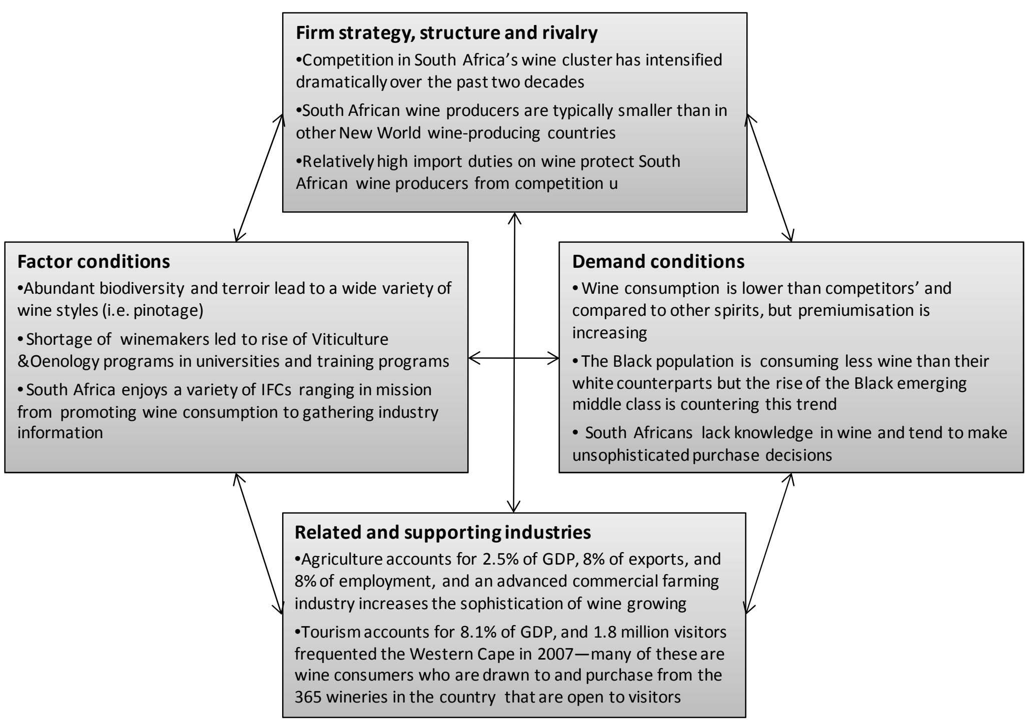
Figure 8: South African Wine Key Export Markets



Source: WOSA

Cluster Diamond Analysis

Figure 9: South African Wine Cluster Diamond



Factor Conditions

Location, Natural Resources and Endowments: South Africa's wine production is concentrated in the Western Cape, located at the confluence of the Indian and the Atlantic oceans. There are over 110,000 hectares of land under vine cultivation, with over 300 million vines of which 60% goes into wine production. Production is handled by 82 estates and 70 cooperative cellars (SouthAfrica.info, 2008 and Vinnovative Imports, 2005).

Terroir is defined as the complete set of local (natural and non-man controlled) conditions in which a particular wine or family of wines is produced, including soil-type, weather conditions, topography and wine-making savoir-faire (Wikitionary, 2009). South Africa enjoys fantastic *terroir* to grow high-quality wine. The country is one of only three Mediterranean wine growing climates in the world.

Physical Infrastructure*:* South Africa's physical wine infrastructure seems to be a slight competitive disadvantage. The high and uncompetitive bottling costs of the industry are worrisome: Distell, South Africa's leading producer, estimates that bottling and packaging costs are approximately €1 per case cheaper in Europe than in South Africa (Fin24.com, 2006). Many importers are therefore importing bulk wine to be bottled in their home market. SAWIS reported that while bulk wine exports rose by 22.3% in 2005, packaged wine exports fell by 1.5% (Fin24.com, 2006). Considering that packaging costs make up around 50% of the total cost of producing a bottle of wine and that wine bottle costs make up half of packaging costs, this is very considerable (Fin24.com, 2006).

The higher bottling costs seem to be due to higher local glass, paper and printing costs due to smaller volumes and a lack of economies of scale. 75% of local packaging is handled by one player: Consol (Fin24.com, 2006). Industry consolidation and the lack of competitive pressures are putting upward pressure on the wine industry's cost structure.

Administrative Infrastructure*:* The administrative infrastructure is quite favorable. It is much easier to obtain a wine license than a liquor license in South Africa. South Africa's legislation allows supermarkets to sell wine, whereas they are not allowed to sell RTDs, beers and spirits (Euromonitor, 2009). Papsak wine (low-quality wine packaged in pouches), a legacy of the dop system (where workers are paid with low quality wine instead of money) (Kapila, 2009), is still prevalent in the country despite the fact that the Western Cape Liquor Act outlawed this practice in 1961. A proposed legislation to ban papsak wine has been debated recently (Euromonitor, 2008). Whereas such legislation would likely discourage the production of low-quality wine and promote that of high-quality wine, it would also distort the market.

Information Infrastructure*:* The South African wine cluster has over 15 wine associations and institutes for collaboration which are providing services such as marketing, export promotion and data-gathering .[2] However, it seems that many of these overlap in scope and mission.

Science and Technology*:* Despite some internal criticisms about the level of research in the wine industry, South Africa has a strong tradition of research. More recently, South Africa has established itself as one of the New World leaders in *terroir* research. For over 10 years, a multi-disciplinary program has been carried out at the ARC Infruitec-Nietvoorbij Institute of Viticulture and Oenology in Stellenbosch and the University of Stellenbosch (WOSA, 2009). This research has had a great impact on better matching between varieties and locations in the Cape winelands and on current viticultural practices that has unlocked the potential of new wine growing areas (WOSA, 2009).

Human Capital: The story of human capital in the wine cluster is mixed. On the one hand, due to South Africa's tradition in the wine industry, there are numerous Viticulture and Oenology programs in the country and scholarships are available in universities. However, these programs have not had very strong participation from the black South African population. This has led to a domestic shortage of sophisticated black winemakers.

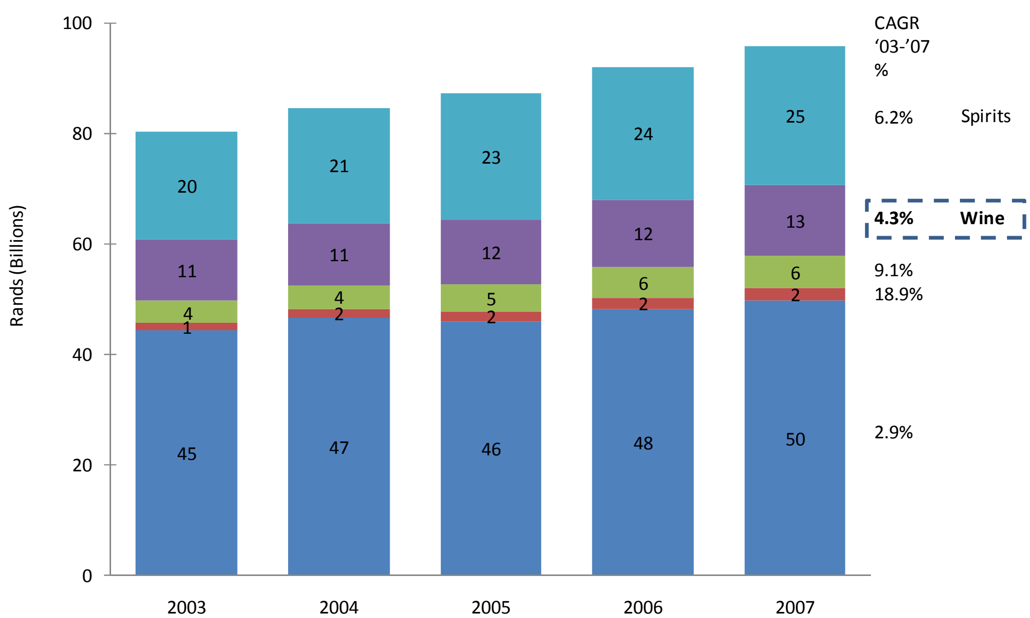
[2] These associations include: Wines of South Africa (WOSA), South Africa Wine Industry & Systems (SAWIS), Agricultural Research Council (ARC), Biodiversity and Wine Initiative, Cape Winemakers' Guild, Chenin Blanc Association, Institute of Cape Wine Masters, Integrated Production of Wine scheme, Methode Cap Classique Producers' Association, Pinotage Association, South African Society for Enology and Viticulture, South African Wine Industry Council, South African Wine Industry Trust, Wine Industry Ethical Trade Association.

Financial Capital: South Africa's wine industry enjoys good access to finance. Since 1997, Nedbank has established itself as the provider of specialized financial to the wine industry. Nedbank currently has a wine-industry asset book exceeding a billion rand (Hill, 2004). Nedbank provides both direct (backing for farm purchases, specialized import service, debt finance, etc.) and indirect assistance (yearly donations to industry associations, etc.) (Hill, 2004). The Nedbank Cape Winemakers Guild Development Trust supports the education and social needs of farm workers and their families (WOSA, 2009).

Demand Conditions

At R15 billion in 2008, the South African wine market was still lagging behind the larger categories of beer (R52 billion) and spirits (R29 billion). The wine sector experienced modest growth from 2003 to 2007, growing at a CAGR of 4.3% (Euromonitor, 2009).

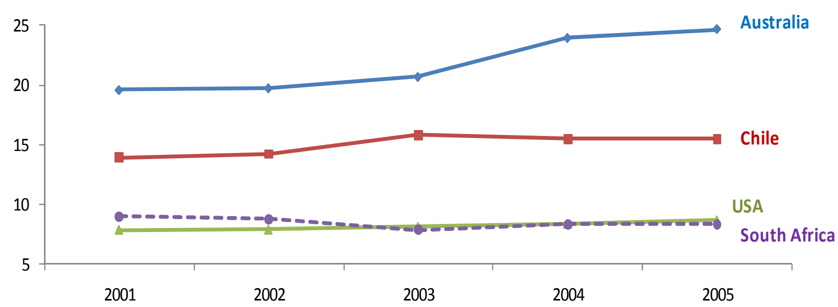
Figure 10: South African Market for Alcoholic Beverages



Source: Euromonitor, 2009

South Africa's wine consumption per capita (8.37 liters / capita in 2005) is also lagging. This can be explained by the fact that the black South African population still considers wine to be an inaccessible drink. 80% of the South African population is black and their "non-consumption" has therefore kept the aggregate national consumption low.

Figure 11: Selected Countries' Annual Wine Consumption per Capita (Liters)



Sources: Trade Data and Analysis, Heritage Link Brands, Euromonitor, FAO

Marilyn Cooper, managing director of the Cape Wine Academy and organizer of the Soweto Wine Festival, explains:

> "Wine drinking is still seen as elitist and white among the black population who traditionally have drunk beer and brandy. A lot of them think, 'That's not for me, it's for the whites'." (The Independent, 2007)

Adding to the inaccessibility of wine for the Black population is the fact that their participation in the industry has remained limited. The South African Black Vintners Alliance estimates that as a result of apartheid, there are only 25 black winemakers in South Africa (The Independent, 2007).

Despite the fact that the majority of wine South Africans consume is of low quality (in 2007, 82% of white wine consumed retailed for less than R25), premiumization has been increasing in the wine industry (Euromonitor, 2008). The share of white wine sold for more than R25 increased from 11% of total wine consumption to 18% in 2007 (The Independent, 2007). In 2007, wine sales continued to indicate a share shift from low-end to high-end, as consumers sought out quality wine that reflect a higher social status (The Independent, 2007).

Context for Firm Strategy, Structure and Rivalry

The KWV had a profound impact on rivalry in winemaking since 1918, as it was empowered by Parliament to set and enforce production quotas for all growers and to set minimum prices for grapes to eliminate "harmful" price competition. It was "a system which tended to handicap the private wine producer and favor the bulk grape-grower." (Robinson, 2006). This state of affairs persisted until the 1990s, when the KWV was relieved of its regulatory authority and converted into a private company. The effects on the industry were quickly felt. The number of grape farmers in South Africa fell 16% between 1991 and 2007, suggesting consolidation motivated by farmers seeking economies of scale; during that same period, the number of winemakers more than doubled, likely in response to increasing returns to quality that market de-regulation and the opening of export markets permitted.[3]

Today, the structure South African wine industry resembles those of New World producers like the United States and Australia in terms of producer concentration.

South African wine producers are typically much larger than those in Europe, producing 1.75 million hectoliters on average versus 200,000 hectoliters in France, for example (Roberto, 2003). This allows South African winemakers to achieve economies of scale (albeit not to the extent of winemakers in the United States and Australia, where average production is even higher). Therefore, there are many fewer wine producers in South Africa: 68,500, versus 232,900 in France, for example (Roberto, 2003).

However, South African wine producers, who (as already noted) sell nearly 75% of their output on the domestic market, are protected from foreign competition. Historically, South Africa levied extremely high import duties on wine, sometimes as high at 160% (Ntege, 2001). Since 1996 these tariffs have been reduced to 25% for wine from non-EU countries (a bilateral trade agreement with the European Union secured lower tariffs for European imports). Nevertheless, this tariff is still high compared to import duties on wine that other important wine producers

[3] http://www.sawis.co.za/info/download/Book_2008_web.pdf

impose. Chile, Australia, the United States, and the EU all impose tariffs of 6% or less on imported wine. [4]

Related and Supporting Industries

The wine cluster is adjacent to two important South African industries, tourism and agriculture. South Africa is the 28th most visited country in the world, and experienced 5% annual growth in international arrivals 2002–2007.[5] In 2007 tourism accounted for 8.1% of GDP, when South Africa received 9.1 million international arrivals; of these, 1.8 million visited the Western Cape, where they spent R18 billion ($2.6 billion).[6] The top three countries of origin for international visitors to the Western Cape are the United Kingdom, Germany, and the United States—all major wine consuming countries. The Cape winelands are less than an hour's drive outside of Cape Town, and there is an extensive tourist infrastructure of hotels and restaurants. Indeed, 145 wine producers in South Africa have organized into "wine routes" catering to tourists, offering tastings and bottle sales.[7]

Agriculture is another successful South African industry the strength of which supports the wine cluster. South Africa is a net food exporter and self-sufficient in most agricultural products. Agriculture accounts for 2.5% of GDP, 8% of exports, and 8% of employment.[8] It boasts significant competitive advantages, including an advanced infrastructure relative to that of the rest of the continent, counter-seasonality to Europe, plentiful availability of cheap labor, and free-trade agreements with many important markets.[9] Aside from grapes used for wine production, South Africa is among the top five exporters of table grapes globally.[10] However, large-scale commercial agriculture coexists with sub-scale subsistence agriculture, a legacy of apartheid. Under an

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[4] http://www.export.gov/static/Chile_tariff_schedule.pdf, http://www.apectariff.org/tdb.cgi/ff3133323230/apeccgi.cgi?AU, http://www.export.gov/static/EU_tariff_schedule.pdf, and http://www.usitc.gov/tata/index.htm.
[5] http://www2.southafrica.net/satourism/research/viewResearchDocument.cfm?ResearchDocumentID=477
[6] http://www.tourismstellenbosch.co.za/userfiles/1/file/2007%20Destination%20performance%20report.pdf
[7] http://www.wineroute.co.za/subroutes.asp
[8] http://www.gcis.gov.za/docs/publications/yearbook/2008/chapter3.pdf
[9] http://www.southafrica.info/business/economy/sectors/agricultural-sector.htm
[10] http://news.reseau-concept.net/images/oiv_uk/client/Commentaire_Statistiques_2005_EN.pdf

ambitious land reform plan, the government plans to redistribute 30% of white-owned commercial agricultural land to previously disadvantaged persons by 2014.

CLUSTER-LEVEL STRATEGIC ISSUES

Factor Condition Issues

Shortage of black winemakers: With only 1.5% of winemakers, black winemakers are still too few to dispel the myths that wine is an “elitist and white” drink and to encourage greater consumption among the black population.

High and uncompetitive bottling costs: The disadvantage in bottling costs is leading to higher proportions of wine being exported in bulk and bottled overseas. This not only affects the capacity utilization and performance of the local bottling operations, but also seriously compromises the quality of South African wine available in international markets. Reports have indicated that when bulk wine is imported, it is sometimes mixed with other wines of lower quality (Fin24.com, 2006).

Low coordination among IFCs: The effectiveness of IFCs is not maximized since their mandates overlap. This results in wasted resources and sub-optimal industry support.

Demand Condition Issues

Low and unsophisticated demand among black South Africans: Despite the growth of the South African Black middle class, the black population is still not consuming significant quantities of wine. Many Black South Africans still consume Papsak wine or sweet wine, depressing the quality of wine since producers have no incentives to improve quality to satisfy local demand.

Export Market Concentration: South African wines are concentrated in a few international markets; 71% of exports are concentrated in the Euro zone and in the UK, thus making exports vulnerable to appreciations of the rand against these currencies.

Firm Strategy, Structure and Rivalry Issues

High tariffs on imported wine: Even though they have considerably decreased over the past few years, South African tariffs on imported wine are still too high. This considerably reduces the supply of imported high quality wine in the country.

Brand Differentiation: South Africa competes against many countries in the competitive “table wine” segment and thus finds it difficult to differentiate itself from the competition.

Presence of capital controls: South Africa’s use of stringent capital controls limits FDI, which could lead to beneficial knowledge and skills transfer in the wine industry.

Related and Supported Industry Issues

Wine tourism not popular among local South Africans: Most tourists who visit the Cape winelands are international. This lack of local tourists not only hinders South Africans’ education about wine, but also increases the likelihood that quality-conscious consumers will choose premium imported wines instead of premium South African wines.

RECOMMENDATIONS

COUNTRY-LEVEL RECOMMENDATIONS

Short-term recommendations

- **Support local highway development** by using central government to facilitate development of local transportation infrastructure across the various provinces.
- **Reduce import tariffs** to force local companies to be internationally competitive and increase local buyer sophistication.
- **Maintain macroeconomic stability, loosen capital controls and further liberalize trade policies** to allow stability necessary for business growth despite current volatility in international markets.

Medium-term recommendations

- **Improve inadequate education system and upgrade worker skills**. In particular vocational training and industry institutes should be further developed. At tertiary level, increase coordination of educational and research focus with industry needs.
- **Fix incentive problems created by Black Economic Empowerment policies** and focus on management training and social services that create long-term opportunities for the black population. This is an urgent, but politically sensitive priority which will take time to implement.
- **Address instability in electricity supply** by privatizing electricity provision and/or facilitating construction of new power generation facilities.
- **Tighten regulatory standards** to increase sophistication of domestic products.

Long-term recommendations

- **Toughen regulations on union activities** which maintain labor market rigidity. Create necessary goodwill to push this agenda through progress on black empowerment efforts.
- **Develop cluster development and collaboration strategy** for high potential clusters. Focus on policies which will help all clusters without choosing favorites. Also, diversify economy by supporting cluster development in service sectors.

CLUSTER-LEVEL RECOMMENDATIONS

Short-term recommendations

- Stellenbosch University and other universities could offer **scholarships to Black students for viticultural programs**. Nedbank's Trust could contribute to them.
- **WOSA should become the umbrella organization of all IFCs** to ensure that mandates and responsibilities are clearly defined and do not overlap.
- **WOSA should continue to support events such as the Soweto Wine Festival** (organized in predominantly black neighborhoods) that help educate the Black population about wine.

- **WOSA should develop a high-end premium sub-brand, distinguished by varietal or appellation**, to promote increasing winemaker sophistication. Pinotage would be an excellent option to develop this brand.
- **WOSA and the South African FIFA chapter should take advantage of the 2010 World Cup to publicize South African wine**. The premium sub-brand would be an ideal "sponsor" of the South African team that could be featured on marketing materials. This should allow WOSA to reach an audience of international tourists coming from a wide range of countries.

Medium-term recommendations

- Parliament should **further reduce tariffs on imported wine**. Whereas some could argue that this will have the impact of increasing imported wine consumption over domestic wine consumption, it will actually contribute to increasing the sophistication of South African consumers
- Parliament should **reduce (and potentially eliminate) capital controls**. This will be beneficial for the wine industry. The feasibility of this measure might be compromised by the inflation targeting policy that the Central Bank is pursuing. Parliament should therefore coordinate with the Central Bank.
- **WOSA should encourage winemakers to focus on the U.S.** WOSA could facilitate this by organizing road shows in the U.S. and encouraging the participation of South African wine brands in American wine festivals and tastings.

Long-term actions

- **Western Cape Tourism Authorities should launch a TV branding campaign about wine tourism** to publicize it to the local population.
- **South Africa should also aim to penetrate the growing regional wine market**. South Africa should position itself as the premier African wine producer and aim to increase its

shelf space in markets where the middle class is growing quickly (e.g. Angola). It is critical that high-quality wines are exported to these markets to create from start the perception that South African wine is high quality.

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