Senate Inquiry into the Australian Grape and Wine Industry
Rural and Regional Affairs and Transport Standing Committee

Joint submission by the Clare Region Winegrape Growers Association and Clare Valley Winemakers Inc

Prepared by Sandy Hathaway, May 2015

Key points

The single most significant issue currently facing the Clare region's wine industry is wine prices being too low.

Grapegrowers are supportive of initiatives concentrated on improving the profitability of wine through earning increased wine prices

Retailer power and dominance in the wine market in Australia is considered to a very significant issue preventing the return to profitability of the industry

The best way for government to support the industry in the Clare region is to help facilitate direct-to-consumer marketing and delivery strategies by individual wine businesses and regional associations as well as adjusting policy settings to drive growth in exports and assist with re-balancing supply and demand.

The most important action that government can take to support our industry is to restrict eligibility for the WET rebate to Australian producers who sell bottled wine.

Summary of recommendations

Continue to address retailer power – eg through looking at vertical integration and unconscionable commercial practices designed to drive wine prices down.

Provide support for small producers to establish a direct route to market to combat the market dominance and low margins paid by retailers

Direct government marketing funds and industry levies to individual businesses, with AGWA playing an oversight and quality assurance role

Maintain or enhance the Export Market Development Grant scheme

Remove the WET rebate on bulk and unbranded wine as per the WFA submission

Modify the Label Integrity regulations to require wineries to report to growers, on a regular basis, the destination of their fruit

Facilitate the establishment of a mandatory national vineyard register that meets the needs of industry at an individual and regional level as well as a national level, to be owned and administered by the industry through AGWA.

Preamble

The Clare Valley is a premium wine region that is well suited to winegrape growing, given the absence of major disease or climate pressures. The industry is characterised by great diversity in business structures and varieties grown (although Riesling, Shiraz and Cabernet Sauvignon dominate) and particularly by a predominance of small, family-owned wine producers, since the "major" corporate wine companies have almost completely withdrawn from the region over the past ten years.

It is innovative – eg in experimenting with new varieties and in initiatives like the Gourmet Weekend, which originated in Clare, the world-famous Riesling Trail, and most recently "Clare Valley Rocks" – an education program for tourists which tells the story of the geology of the Clare Valley and its relationship to the grape growing and wine industries.

The wine styles most associated with the Clare Valley are dry Rieslings and medium-bodied but well-structured red wines with good varietal definition and elegance. The region has an international reputation for excellent wines and "punches above its weight" in terms of its performance in wine shows.

The Clare region is made up of small, genuinely rural townships – with the advantages of being close-knit communities but the vulnerabilities of depending on the continuation of a few significant industries to keep them thriving.

While the major industry in the Clare region is broad-acre agriculture, the wine industry is important for bringing tourism to the region as well as providing direct local employment. The combination of agricultural enterprises and winegrowing/tourism has led to the evolution of a specialist gourmet food industry – everything from virgin olive oil and cherries to capers, carob and pistachios – plus associated fine dining, as well as other attractions including a thriving local art industry.

Currently there are approximately 5,500 hectares of vines in the Clare Valley, which produce a total of around 21,000 tonnes of grapes, or 17 million bottles of wine, a year. Expansion of the winegrowing industry is limited by the availability of natural water and the cost of imported water supplied by the SA Water network for irrigation.

Independent grapegrowers account for approximately 50% of grapes grown in Clare; the other 50% being grown by winemaker-grapegrowers as part of an integrated business model.

Grapegrower profitability

Related terms of reference:

- *The profitability of wine grape growers and the steps industry participants have taken to enhance profitability*

Grapegrower profitability in Australia is at its lowest level ever, after a ten year period of consistent national annual vintages over 1.6 million tonnes, reduced international demand for Australian premium wine, falling average value of exported wine, unfavourable exchange rates and increased local competition from imported wines (particularly New Zealand Sauvignon Blanc, which in 2013 accounted for one in every ten bottles of wine sold in Australia).

In Clare, as in most other cool climate regions in South Australia, the combination of low grape prices per tonne and low yields has meant that income from grape production over the past five years has not covered even the variable cost of production for most varieties. In 2014, the average price paid for Riesling was just over $1000 per tonne, the same as it was in 2000 and again in 2006 after a short period of growth where it reached $1500 in 2004.

Figures published for Clare by the Wine Grape Council of SA (see attached) show that, based on average yields and average prices paid in the region in 2014, **over 90% of all grapes were sold at below the cost of production in that year**. This is based on cash costs only, not including water purchases, depreciation, finance costs and return on investment. The finding is consistent with the results of a similar analysis done by the Winemakers Federation of Australia in 2014, which reported that 93% of grape production around Australia was unprofitable.

Costs of production over the past 10 years have increased significantly due to a combination of rising labour costs, utility and fuel prices, inflation and escalating water prices. Individual businesses and their regional associations expend considerable energy on an ongoing basis, on finding ways to increase efficiencies and reduce cost pressures for growers and wineries. In Clare, a particular issue is the cost of water. Negotiations with SA Water have led to a commercial arrangement that will see a reduction in the cost of summer water for many of the region's winegrape growers in 2016.

However, we do not believe that reducing the costs of production is the answer to improving grape prices. Areas of cost-cutting such as reduced chemical use, selection of cheaper chemical products, switching to using gangs of overseas workers who do not contribute to the local economy, lack of investment in "non-essential" activities such as training and biosecurity and in new equipment or infrastructure, are counter-productive in the longer term and lead to a further downward spiral of reduced inputs leading to reduced quality or further degradation of the vineyard asset and in turn to further reduced prices. **Furthermore**, **any cost-savings achieved will be absorbed by other elements in the value chain that have greater market power – specifically retailers (see below)**.

Wine prices

The single most significant issue currently facing the Clare region's wine industry is wine prices being too low.

The decline in the average value of Australian wine since 2000 is well documented. For example, the average price per litre of wine exported to the UK was £2.18 in 1998 and £1.42 in 2013 – a drop of over 30%. Domestic sales prices are insufficient to cover the costs of production, a problem compounded by constant discounting of wine (85% of wine in Australia sold through major retailers is sold at a discount on the supposed recommended retail price).

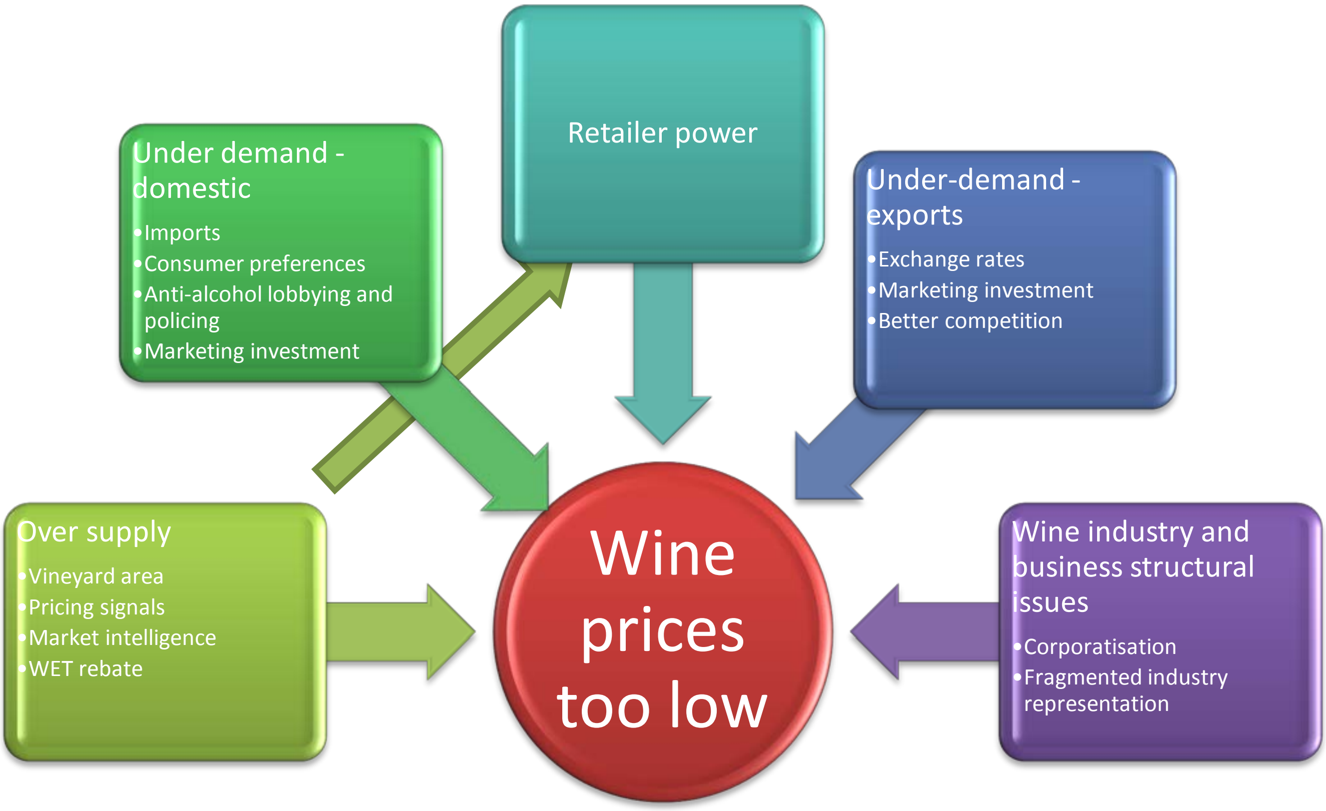
While there is an argument in the area of food staples that low prices delivers benefits to consumers, it is hard to sustain any 'social good' argument along these lines when it comes to alcoholic beverages. In fact it can be argued that we are effectively trading viable rural communities for 'cheap booze'.

Grape prices will continue to be low while wine prices are low. As wine producers have more power than independent growers, ultimately the pricing pressure is passed on to them in reduced grape prices. Any attempts to directly improve grapegrowing profitability – eg through cost reductions, grower assistance packages or cutting supply – are likely to fail in the current environment, where more dominant players in the value chain (particularly the two major retailers: Woolworths and Coles) and international competitors with better marketing, lower labour costs etc will be able to claim any improved margin and hence keep grape prices low.

Therefore:

Grapegrowers are supportive of initiatives concentrated on improving the profitability of wine through earning increased wine prices

Wine prices are too low as a result of a number of factors, some of which act both directly and indirectly. The diagram below gives a *simplified overview* of what we believe to be the main factors contributing towards low wine prices.



Addressing these issues is likely to require a number of different strategies and involve a number of different players, while there are some that cannot be easily or practically addressed. The following factors have been identified for further consideration in this submission because we believe they are areas where government involvement can assist:

- WET rebate
- Retailer power
- Marketing investment
- Pricing signals / market intelligence.

WET rebate

Related terms of reference:

- *The impact and application of the wine equalisation tax rebate on grape and wine industry supply chains*
- *The extent to which federal and state legislative and regulatory regimes inhibit and support the production, processing, supply chain logistics and marketing of Australian wine*
- *The extent and nature of any market failure in the Australian grape and wine industry supply chain*
- *The power and influence of retailers of Australian wine in domestic and export markets*

We strongly support the industry proposal to government that eligibility for the WET rebate be removed from bulk and unbranded wine, and from non-Australian wine producers. We believe that this action is critical to the recovery of the industry.

The WET rebate was originally intended to support small and medium sized winemakers and to promote tourism in regional areas through increased incentives to open cellar doors. It has grown from a 14% rebate with a cap of $290,000 to a subsidy of 29% on wholesale sales value with a cap of $500,000 and as such has become a significant distorting influence on the operation of the wine market.

We believe the WET rebate contributes directly to over-supply by sustaining otherwise unprofitable wine production. It also contributes indirectly through making the export of wine less attractive and hence pushing more product onto a static and over-crowded domestic market, thus increasing retailer power and ability to drive margins down. Effectively this government subsidy on wine production (it is not in fact a rebate) is being passed on to consumers as cheaper wine or pocketed by the major retailers.

Restricting the availability of the WET rebate to packaged, branded products produced by businesses with an Australian producers' licence and sold direct to consumers would assist small producers in two ways:

- directly as financial support for their activities and
- indirectly by reducing competition from unfairly subsidised wine on the domestic market that goes into retailer-owned brands

We believe that this is the most important action for government to take in assisting industry to address the issues currently facing it and return to profitability.

Recommendation / proposal for government action

Remove eligibility for the WET rebate from bulk and unbranded wine and restrict to producers with an Australian producers' licence

Retailer power

Related terms of reference:

- *The power and influence of retailers of Australian wine in domestic and export markets*
- *The extent and nature of any market failure in the Australian grape and wine industry supply chain*
- *The extent to which federal and state legislative and regulatory regimes inhibit and support the production, processing, supply chain logistics and marketing of Australian wine*

Retailer power and dominance in the wine market in Australia is considered to a very significant issue preventing the return to profitability of the industry.

We will leave it to the national wine industry organisations to provide evidence and arguments about the types of behaviour in the marketplace that drive prices down through control of distribution channels and consumer promotions, making it extremely difficult for wine companies to sell wine profitably in the domestic market except with highly sought after premium brands (in very small quantities). However, we would be happy to provide region-specific examples of this behaviour in support of the national case if requested.

There are already government initiatives underway to address claims of unconscionable conduct by the two main players: Woolworths and Coles, and to put a regulatory framework in place such as the Food and Grocery Industry Code of Conduct to protect smaller suppliers. However, there appears to have been little impact on the behaviour of the major retailers, and certainly no discernible improvement in wine prices. While an environment of supply-demand imbalance continues to exist and low cost imports are available as alternatives to local products, it is unlikely that retailer power will diminish. Therefore regulatory intervention or at least investigation by government is critical to protect wineries and grapegrowers.

Recommendation / proposal for government action

Continue to address retailer power – eg through looking at vertical integration arrangements, labelling of retailer-owned brands and unconscionable commercial practices designed to drive consumer prices down at the expense of producer margins.

The small producers that make up the majority of the industry in Clare have very little ability to negotiate with the large retailers compared with the large corporate wine companies (who themselves have little bargaining power). The most effective and profitable strategy for these small producers to counter major retailer dominance is to sell directly to consumers – through the cellar door, online, mail order and wine clubs.

Therefore the best way for government to support the industry (in this region) is to help facilitate direct-to-consumer marketing and delivery strategies by individual wine businesses and regional associations, for example through:

- Direct assistance to businesses through initiatives such as the Export Market Development Grants scheme (to encourage export efforts in place of competing in the overcrowded and static domestic market)
- Restricting eligibility for the WET rebate to the intended beneficiaries of the scheme (small producers who sell direct to consumers) – see previous discussion.
- Grants for investment in tourism infrastructure
- Increased prioritisation and investment in marketing of the region by the state and national tourism commissions

Recommendation / proposal for government action

Provide support for small producers to establish a direct route to market to combat the market dominance and low margins available through traditional wholesale distribution and direct to retailers

Marketing investment

Related terms of reference:

- *The extent to which federal and state legislative and regulatory regimes inhibit and support the production, processing, supply chain logistics and marketing of Australian wine*
- *the extent to which grape and wine industry representation at regional, state and national level effectively represents growers and winemakers with respect to equity in the collection and distribution of levies;*

Growing demand for Australian wine requires an increased investment in marketing. Currently the Australian Grape and Wine Authority (AGWA) controls all collective funds available for marketing (obtained through levies collected from wine companies) and has a strategy in place for marketing "brand Australia", which in turn is expected to increase demand for individual Australian wine products – at least in export markets. The logic to support this strategy is questionable, as individual products, brands and companies, rather than countries, compete for market share. AGWA also offers a number of export marketing programs and services that can be accessed by individual wine businesses (such as trade shows, tastings and retail visits) but these are too expensive for smaller wine producers to participate in. Despite paying a levy therefore, smaller producers arguably receive very little net benefit from either the overall "brand Australia" marketing initiatives or the user-pays activities that they cannot afford. AGWA activities necessarily also involve a high administration cost, which further reduces the funds available for genuine marketing activities. **There is no support provided for marketing activities in the domestic market at a national level.**

The alternative for small producers who wish to sell their products on the export market is an Export Market Development Grant. This scheme is directed at small businesses, is generous and is relatively easy to qualify for. However, it is not specific to wine, does not include domestic marketing activities, and is not discriminatory in evaluating the marketing activities or the nature of the exported product – thus not providing any quality assurance that the activities will be effective, or that the products being marketed will enhance Australia's image or build demand for Australian wine.

Therefore we believe that more direct, targeted marketing support should be provided to individual wine producers and that AGWA's role should be one of oversight to ensure that funding allocated is spent on relevant, appropriate activities that are likely to be effective. In addition, we believe that the Export Market Development Grant scheme should be maintained or increased – possibly extended or complemented by another scheme to cover direct-to-consumer *domestic* marketing activities (see discussion above under retailer power).

Recommendation / proposal for government action

Direct government marketing funds and industry levies to individual businesses, with AGWA playing an oversight and quality assurance role

Maintain or enhance the Export Market Development Grant scheme

Pricing signals and market intelligence

Related terms of reference:

- *The adequacy and effectiveness of market intelligence and pricing signals in assisting industry and business planning*

Pricing signals

Ineffective pricing signals contribute to low wine prices by giving growers insufficient information to produce grapes that match the specifications required by their purchaser, by failing to reward quality and hence motivate quality improvement and by preventing growers from making informed business decisions based on the knowledge of where their fruit ends up.

Full disclosure of the destination of fruit, supplied by the winery to the grower so that they are fully informed of end use, would enable growers to make business decisions about future production accordingly, would improve relations between grower and winery, improve the efficiency of the value chain and hence should improve the correspondence between supply and demand. It would be possible to use the information collected for the purposes of the Label Integrity Program to provide individual grower feedback, and this in turn could become a marketing advantage at the winery, region or national level.

Recommendation / proposal for government action

Modify the Label Integrity regulations to require wineries to report to growers, on a regular basis (annually), the destination of their fruit

Market intelligence

Information about the industry and the market is critically important to good business decision-making by growers. Currently the Clare region has access to good summary information on vineyards from the Phylloxera and Grape Industry Board's database. The database provides good information on vineyard plantings because it is mandatory for growers to supply their information to it. This is a good model to extend nationally, to provide industry with information such as yields, benchmark costs, production forecasts, price dispersion etc., to support grower, winemaker and industry decision-making related to plantings, production, business investment and allocation of resources.

We support the principle of a mandatory national vineyard database although issues of ownership, access, support and engagement by growers, cost and administration need to be resolved.

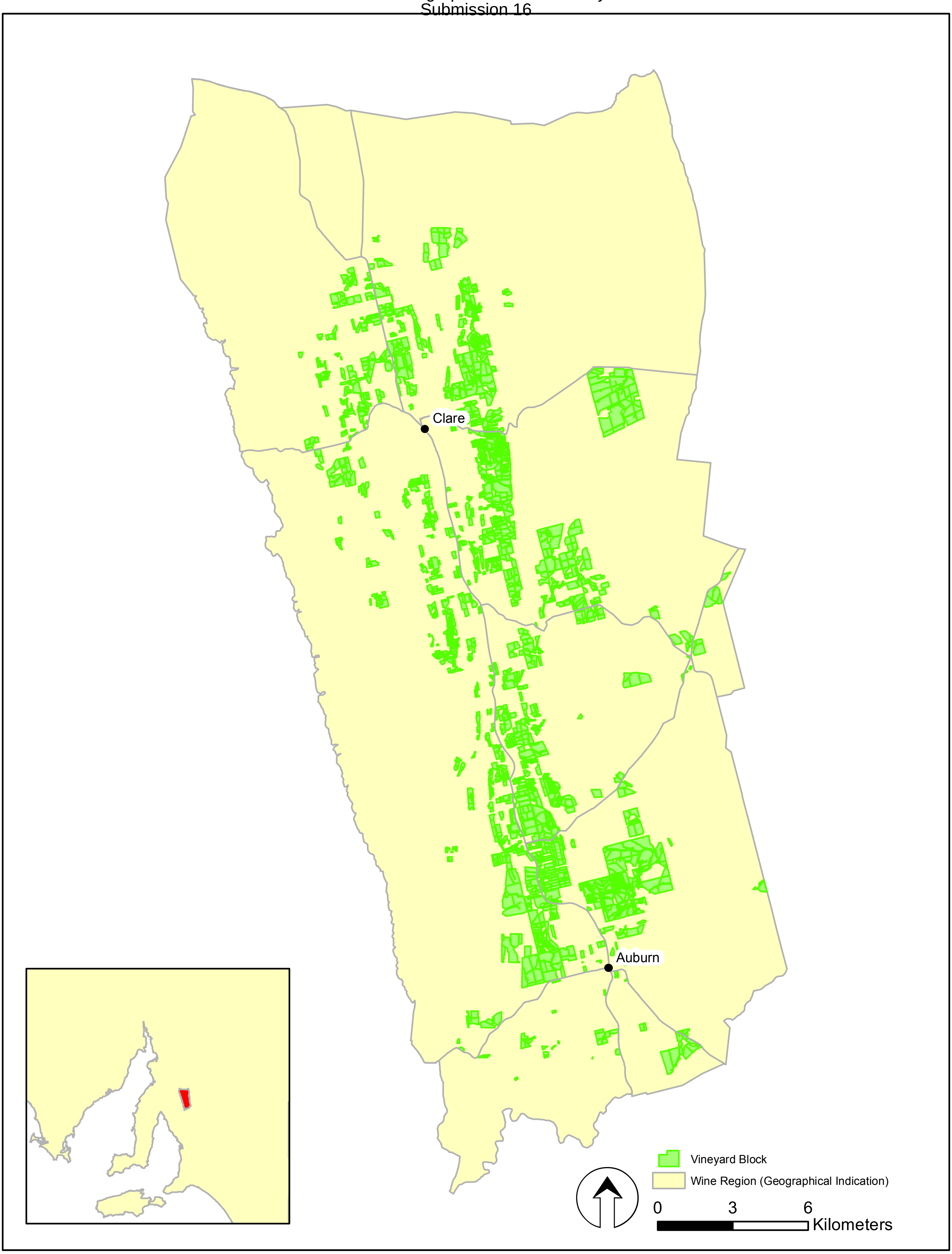
Recommendation / proposal for government action

Facilitate the establishment of a mandatory national vineyard register that meets the needs of industry at an individual and regional level as well as a national level, to be owned and administered by the industry through AGWA.

Anna Baum
Executive Officer, Clare Region Winegrape Growers Association
21 May 2015

Attachments

GI region map of Clare Valley showing townships and industry information
Clare region profitability analysis 2014



DATUM: GDA94
PROJECTION: MGA Zone 54
DATE: 26th July 2013
SOFTWARE: ESRI ArcGIS v10.1
DATA SOURCE:
Vineyard Blocks - PGIBSA
Wine Regions - Wine Australia
Localities - SA Gazetteer
Roads - DTEII

Clare Valley Wine Region

Phylloxera and Grape Industry Board of South Australia

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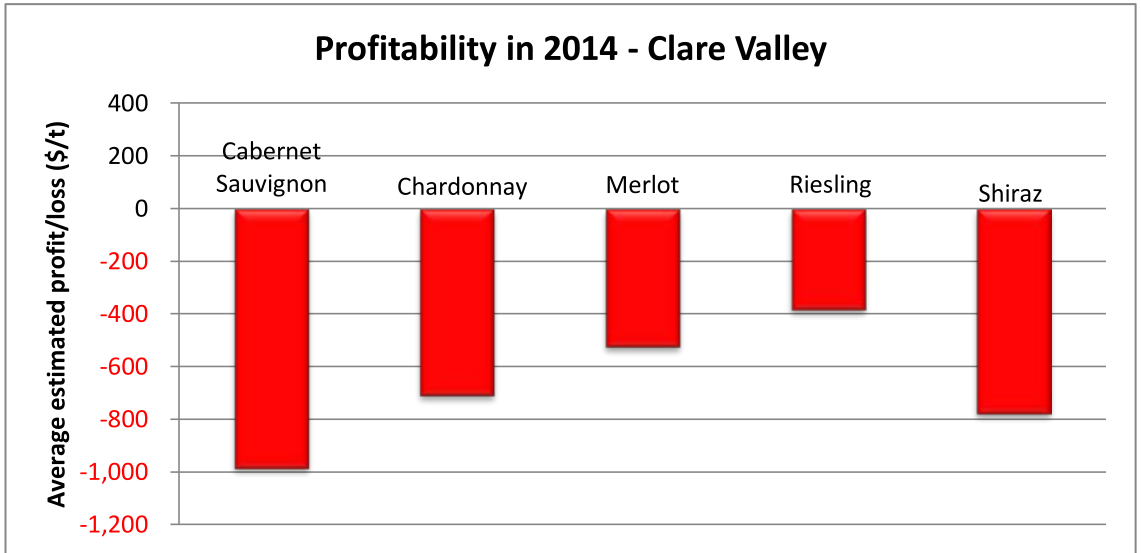
Regional report card - vintage 2014

Clare Valley

Wine Grape Council SA

Profitability analysis by variety

	2014 Regional Harvest Outcomes							Planning for 2015		
	Average yield t/ha* (A)	District average price $/t (B)	Gross $/Ha (A x B) (C)	Est cost of production (COP) $/Ha** (D)	Profit $/Ha (C-D)	Profit/Loss $/t in 2014 B - (D ÷ A)	% tonnes sold below COP***	5 year ave yield t/Ha* (H)	Break even $/t (D ÷ H) (I)	Difference: 2014 district average & break-even price (B - I)
Cab Sauvignon	3.1	$1,193	$3,698	$6,750	-$3,050	-$984	100%	3.2	$2,081	-$888
Chardonnay	5.0	$650	$3,250	$6,750	-$3,520	-$708	100%	5.2	$1,299	-$649
Merlot	5.2	$770	$4,004	$6,750	-$2,730	-$523	98%	5.5	$1,236	-$466
Riesling	4.8	$1,010	$4,848	$6,750	-$1,862	-$385	92%	5.1	$1,334	-$324
Shiraz	3.2	$1,310	$4,192	$6,750	-$2,512	-$777	86%	3.4	$1,995	-$685



This information should be used as a guide only. Production costs and returns can vary considerably. The purpose is to give vineyard owners and managers a simple financial illustration that can be adapted to their own situation to assist with planning.

Summary of key points - 2014

- Yields were 5% down on five year average
- The average price paid per tonne for all major varieties was well below estimated cash cost of production
- Losses for most varieties were between $2,000 and $3,500 p/ha on average
- Approximately 15% of Shiraz was sold at above estimated cost of production – for all other varieties over 90% was sold below the cost of production.

Looking ahead to 2015

- Based on average yields for the past five years, none of the major varieties would be expected to cover cash costs if the price paid was equal to the 2014 average price.

Notes

** Figures derived from the SA Winegrape Crush Survey*
***Cash costs only – excluding water, depreciation, finance costs and return on investment*
****Price dispersion information from the AGWA Price Dispersion Report 2014*