Wine Distribution Channel Systems in Mature and Newly Growing Markets: Germany versus China

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Abstract

The wine industry is one of the most globalized industries in the world. Traditionally, wine has been viewed as a European product. In terms of consumption, the European Union (EU) market is shrinking today. However, Asian countries as China, Japan and Taiwan have increased their wine consumption significantly during the last five years and today they represent export markets of high potential (Lee, 2009). It becomes crucial to understand the distribution channels system development on these markets. We focus in particular on French wines significantly present on both markets.

Keywords: wine distribution channel, mature market, emerging market, Germany, China, French wines

Introduction

Marketing channel decisions involve supply chain strategy at the policy level and channel management at the operation level. The complexity of these decisions is increased by widely different social, cultural, economic, and political patterns. Many approaches to distribution channels analysis exists. Although it is an important issue, there are a limited number of studies on international distribution channel (Cabaniss 1991; Griffith and Ryans 1995; Rosson and Ford 1980; Samiee 1993, Seifert and Ford 1989). Two general approaches are derived from a dichotomy arising in the literature, in the economic, physical, technical “hard” side and in the social, psychological, “soft” side. Wine distribution channels in wine sector remains a much understudied research field, and we hope through our research some of the important issues of this topic are uncovered.

Miracle (1965) suggests that the distribution policies should be considered as the characteristics of products. The specificity of the wine industry in terms of distribution channels comply with this statement, because wine production follows a rigid yearly cycle, wineries must allocate production across several sales channels before demand is known. Wine distribution is especially challenging due to the complex rules and restrictions (Camp, 2004). While the analysis of channel in one country does not provide sufficient answers for conducting activities in another country, it is crucial for wine companies to understand the different systems behind the wine distribution channels in different markets.

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We have chosen a typical mature market (Germany), to compare it with an emerging wine market (China), we attempt to tract the similarities and analyze the differences between their distribution channel systems. We focus in particular on French wines significantly present on both markets.

Having carried out forty nine interviews with French wine producers, Chinese wine distributors and German distributors and triangulating these sources with the information also collected from research papers, online sources, government reports, consultant reports and medial search, we present the main differences of the two markets, mapping the distribution channel systems for both markets, explaining the reasons of the differences, and tracking the evolution trends from an emerging market to a mature market. The findings show a marked difference between the channel choices on German and China wine markets, based on five different factors (Environment factors, Marketing factors, Customer factors, Company factors and Intermediary factors). Mature markets have laid great focus on off-trade channels, while New developing markets are more likely to choose on-trade channels (such as restaurants; hotel…). However, it also becomes clear that the evolution of channels in emerging markets generates certain bottlenecks, the auto regulation promotes transparency and the development of other channels comes into view, in particular those channels which are favored in mature markets.

The German Market1

Whereas in the 1980s retailers were still dominating in direct sales and sales of specialised wine and delicacies, today the three main distribution channels are discount retail chains (40% market share), retailers (30% market share), and direct sales from the producers (19% market share) (Hanf et al., 2012; Hanf/Schweickert, 2003; Schweickert, 2007). The increase of imported wines came hand in hand with the rise of supermarkets and discount chains– particularly from the new world. These large-scale producers are able to produce large quantities with an acceptable (‘drinkable’) quality at the lowest prices. Furthermore, from the beginning these producers targeted retailers as their main distribution channel, providing them with demanded quantities, modern IT and supply chain solutions. In contrast, the German wine sector is still dominated by small wine growers, with more than 34,375 wine businesses. Nearly half of these

1 The paragraph on the German wine market is based on Hanf et al., (2012).
The rapid rise of supermarkets and discount chains was accompanied or caused by a change in consumer behaviour. Traditionally, in Germany, wine was drunk mainly in wine-growing regions. This wine was generally locally produced and bought directly from the growers or village cooperatives. However, today wine is drunk all over Germany (including non-wine growing regions) and most consumers are occasional wine drinkers. Hence, they are looking for uncomplicated signals, such as reputation of retailers or wine growing regions or countries, as well as brands to signify quality. Imported wines from countries with a long wine tradition, such as France or Italy, have therefore been in much demand among young and middle-class consumers in recent years.

Cooperatives in Germany

Traditionally, wine cooperatives sold the vast majority of their wines directly to the consumers or sold them via small local retailers in their neighbourhood. However, due to the changes in consumer behaviour and in marketing channels, cooperatives must use different distribution channels to market their products (Hanf/Kühl, 2008). Facing the demands of the large retailers, like continuously supplying them on a national basis, has led to some structural adjustments in the cooperative sector. Because the majority of the "wet" wine cooperatives do not create enough quantity and financial assets, they cannot afford to have their own distribution force. Thus, secondary "central wine cooperatives" have gained importance. They mainly operate higher within the wine production chain, selling bottled wine from "wet" wine cooperatives to retailers nationwide. By being centralized and marketing large quantities, they are able to meet the retailers' demands for high quantities paired with high demands of the IT infrastructure (Schweickert, 2007).

In general, the "central wine cooperatives" mediate between the primary cooperatives and the retailers by marketing wine nationwide and managing the relations with the retailers. Therefore, "wet" wine cooperatives can focus their marketing efforts on specialized retailers (special wine stores), local retailers, restaurants, and direct selling. These issues lead to German retailers building new collaborations with private wineries rather than with cooperatives. For example, in order to offer a high-quality German red and white wine, the leading discount chain created an agreement with a leading wineyard in Baden. The winery agreed to deliver a certain quantity at a given (high) quality year-round. However, in order to be able to fulfill these requirements, they had to cooperate with a multitude of grape growers. In order to deliver their grapes these growers (some members of cooperatives) had to accept the strict quality measures and in marketing channels, cooperatives must use different distribution channels to market their products.

In the fiscal year 2004/2005, wine cooperatives produced 3.3 million hectoliters wine, accounting for nearly 35% of the total wine production in Germany. The acreage planted with vines by all members increased up to 31,342 ha, so that more than 31% of all German land area was under cultivation, in particular, in the regions of Baden, Württemberg, and Franken, where grape production is dominated by part-time viticulturists and membership in cooperatives is widespread. In these regions, cooperatives hold a market share of nearly 75%. In 2005, there were over 200 active wine cooperatives. However, only 137 of them possessed their own vinification facilities (Schweickert, 2007). The examination of the German wine market has shown that wine cooperatives have a special role within the market. According to their statutes, wine cooperatives are self-help organizations for wine growers. Their aim is to improve the economic situation of their members by collaboration in vinification and marketing of the grapes or their processed products. Accordingly, the general function of wine cooperatives is to process grapes; produce must; and vinificate (fermentation, fining, clearing, and other oenological practices in the cellar for winemaking), bottle, and market the wine. In accordance with the general cooperative system, a secondary "central-wine cooperative" ("central cooperative") has been established in both of the wine-growing regions of Baden and Württemberg, where there are more than 68 non-vinifying wine cooperatives. For them, "central cooperatives" function as the vinificating unit so that such cooperatives only have to collect the grapes of their wine growers and deliver the grapes of the whole vintage. Another task of the "central cooperative" is to stabilize the supply. Therefore, many of the wine cooperatives with their own vinification ("wet" wine cooperatives) deliver a contractual share of bulk wine from their vintage (Hanf/Schweickert, 2003).

The Chinese Market

China has a long wine history dating back 4,600 years (Fang, 2008), however, the real development started in recent decades. At the beginning of the Chinese economic reform in 1980, Rémy Martin ventured into China to set up the first joint-venture enterprise: Dynasty Wine Ltd, its wines were exported abroad in the first two decades. It was not until after 2000 that the economic boom finally provided the local population with sufficient income to support the domestic market. Other companies, including Ofaco and

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2 The paragraph on the Chinese wine market is based on Boudine-Chameevo et al. (2014).
The Chinese wine industry and market experience has grown substantially in production, consumption, and import over the past decade. From 2000 to 2011, wine production increased from 10,500 mhl to 13,000 mhl (23%). Wine consumption increased from 10,695 mhl to 17,000 mhl (59%), while wine imports (including bottled wine, bulk wine and sparkling wine) increased sharply from 12.5 ML to 162 ML (OIV, 2012). Obviously, China is emerging as an attractive market, albeit a somewhat "unusual" target for foreign wine businesses (Jenster and Cheng, 2008).

The evolution of the Chinese wine sector is heavily influenced by China’s institutions and policies. The volume gain of 583 million liters of wine consumption in Chinese market during 1999 to 2004 was the result of government encouraging consumers to switch drinks Baiju to grape wine, in order to preserve national stocks of rice for food production. According to the Chinese government, the 12th Five-year Plan projections for the wine industry indicate that wine consumption is set to increase alongside rising incomes and lifestyle change. This consumption policy has continued to stagnate in recent years. Lot of domestic wine has been produced from domestic bulk wine blended with cheap imported bulk wine. However, as domestic grape production has improved greatly in recent years, partly because of the advice from French oenologists.

In 2011, China had 560 thousand hectares of grapes for wine making (OIV, 2012) and over 940 wineries in operation; however, the wine market in China is extremely concentrated. The sale volume of Changyu, Cocofo and Dynasty presents over 37% of the Chinese wine market. These companies have well-developed national sales networks covering both off-trade and on-trade channels. However, the local brands are facing challenges from foreign wine brands in terms of price/ratio quality. According to the companies’ interim report, Changyu’s revenue declined in the first half of 2012 for the first time in five years, falling 2.51 % year-on-year to 3.01 billion yuan ($470 million). Cocofo’s sales declined 2.1 % year-on-year and the Sino-French joint venture Dynasty saw a 10.5 % year-on-year slump in its income in 2011. China’s wine companies are mainly located close to the grape supply areas (Jenster & Cheng 2008). Presently, the main areas of expansion are still located in the north. The largest producing region is Shandong with over 140 wineries producing 40% of all China’s wine. The quality of Chinese wine has improved greatly in recent years, partly because of the advice from French oenologists.

China has been described as the world’s fifth largest wine market in sales (Girard, 2013). The Chinese have a cultural tradition of consuming alcoholic beverages, however, it has traditionally been dominated by beer, but since the 1980s, connections have been made to the international wine market, to France in particular, and the taste of Chinese drinkers has begun to change. The 290 % increase in total consumption in ten years (from 246.9 ML to 664 ML) and a sharp increase in wine imports confirm that China is rapidly emerging as an attractive market (Jenster and Cheng, 2008). Sales in 2012 were estimated at 1.6 billion bottles. Compared for example to wine consumption of 47.7L and 37.1 L per capita in France and Italy respectively (OIV, 2013), the per capita consumption of wine in China has a strongly increasing tendency though still remains low (1.12 L in 2012). The country presents a stable valuable market for wines in the very near future. According to Tang (2006), more than 40 % of Chinese wine consumption is through organizations’ purchasing wines for business and relationship-building reasons. For example, organizations serve wine to key stakeholders, such as important customers, government officials, at cocktail parties or formal banquets. The second major consumption category, accounting for nearly 22 % of total wine consumption, is entertainment – an individual purchases wine for social get-together parties with friends or for celebrating a big family event. Only 13 % is private consumption, for personal consumption at home. There is an overwhelming preference for red (accounting 85% of the whole consumption) versus white wine.
markets. As a result particularly in the both dominating distribution channels - supermarket and discount – down and at the sometime basic quality has increased. As a result, today there are no real bad wines on the market. Hence, the last two decades in Germany have shown that the high competition has driven prices down and the availability has increased. In this segment particularly regarding the usage of generic selling propositions and the resulting price competition. This might be good news for Chinese wine consumers as they can expect rather good quality for moderate prices. French producers selling their wine in China today have to ask themselves whether providing France (or a French wine growing region) and good quality as key arguments for selling their wine, will be enough in future. As the German market shows brand building might be a way to avoid price completion to some degree.

Thus, for the Chinese market lessons could be learned regarding the mass distribution channels; particularly regarding the usage of generic selling propositions and the resulting price competition. This might be good news for Chinese wine consumers as they can expect rather good quality for moderate prices. French producers selling their wine in China today have to ask themselves whether providing France (or a French wine growing region) and good quality as key arguments for selling their wine, will be enough in future. As the German market shows brand building might be a way to avoid price completion to some degree.

References:

The Chinese Wine Market (Bouzdine-Chameeva et al., 2014)

Discussion and Conclusion

In our paper we compare two export markets for French wine producers. For a long time Germany is one of its major wine export destinations, while China is recently establishing itself of major importance. However, comparing both wine markets some fundamental differences are getting obvious. Whereas the Chinese wine market is one of the most dynamic and fastest growing markets, the German wine market is rather stagnating since twenty years. Hence, one could assume that the Chinese market is low in competition the German one is very competitive. However, this simplified picture is only partly true.

China as a whole foresees still high growth rates. However, whereas in tier two and tier three cities more and more wine is consumed, particularly in tier one cities growth is more moderate. In these cities already now wine consumption is far above Chinese average consumption. As a result competition within these cities is very high. Furthermore, due to policy shifts in the recent past, luxury wines are facing some pressure. Hence, more moderate priced wines might be demanded. In this segment particularly competitors from other Southern European countries (e.g. Spain, Italy) as well as from the New World enhance competition. Interestingly, these are the same competitors that are also the main rivals for French wine exporters in the German wine market. While in Germany a high amount of white wine is produced and marketed locally in China the overall consumption is mainly focused on red wine. Hence, both markets share that in the context of imports red wine is most important. All-in-all, we conclude that partially competition makes sense and developments from the German market might provide some inside for the future development of the Chinese market.

Hence, the last two decades in Germany have shown that the high competition has driven prices down and at the sometime basic quality has increased. As a result, today there are no real bad wines on the markets. As a result particularly in the both dominating distribution channels - supermarket and discount – quality is not any longer a key differential attribute. Other generic and easy recognizable attributes such as varietal or country of origin have gained importance. However, as the majority of wine consumers in these distribution channels are rather low involved and dispose over relatively low wine knowledge the importance of these generic attributes has to be rather understood as a sign that consumers perceive wine as a homogeneous product. Hence, price competition is resulting with the effect that profits are rather low in this market. Most interestingly, still today most companies use the above named generic attributes (quality, varietal, country of origin) as their main selling proposition. Only, for the last couple of years brand building is getting more important.

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