INTRODUCTION

- Over the last 20 years SA has gone through a wine ‘revolution’
- Prompted by: deregulation and opening of export markets
- Result: investment flowed into the industry
- New vineyards and wine cellars were established
- Modernisation and Upgrading took place

- Wine quality improved
- Export volumes increased dramatically (>5% of total production in 1992 to 47% in 2012)
- However: 65% of exports are bulk (2012)
- Most of it is sold in the ‘popular premium’ or ‘basic quality’ price band (e.g. average in UK market: £ 4.73 per bottle (2013))

- Also: ‘package’ is increasingly demanding
- Many improved processes and obtained certifications are now expected as a ‘given’
- Extras (e.g. promotional support) are expensive
- At the same time: margins are low
- Since co-operatives and ex-coops supply most of the wine, this is mainly an issue that affects them
WHICH WAY FORWARD?

• But: is there a way to a ‘better deal’?

• Value chain theory suggests: further ‘upgrading’, improved quality, more value added

• But: given the classical constraints of coops, is this a viable, realistic option?

• What are these constraints?

• Member heterogeneity (i.e. diverging strategies/interests)

• Control problems (i.e. limited managerial autonomy)

• Influence cost problems (i.e. it takes a long time to ‘convert’ members)

• Horizon problems (i.e. short term outlook of members)

• Free riding problems (i.e. by the poor quality producers)

HAVE THEY ACTED AS A BRAKE ON SA COOPS?

• Case study of three cellars: little evidence that they did

• They each chose a different route/strategy/business model

• In their pursuit they encountered relatively little ‘control’, ‘influence’, or ‘horizon’ problems

• There was resistance at one or two, but not enough to put the cellar off course

• Only at one of cellars was ‘member heterogeneity’ in the sense of ‘small producers’ mentioned as a minor issue

• Here the combined total of 9% rebate and distilling wine could possibly be interpreted as a hindrance and ‘free riding’

• However, even in this case the cellar was not forced to sell large volumes of wine at ‘dumping’ or ‘spot market’ prices

• Thus on the whole the potential weaknesses of a coop did not divert the cellars from their strategic thrust
THE FLEXIBLE SA COOP

• In their endeavour to adapt and reposition themselves SA coops were aided by features which deviate from the classical coop model, but which provide flexibility (‘new generation coop’), for example:

  • The weighted vote
  • The creation of a ‘Pool B’
  • The establishment of subsidiary companies

THREE CHOICES, THREE DIFFERENT OUTCOMES

• In the space provided for by legislation, each of the three cellars discussed in the case studies made their choices, resulting in very different outcomes:

THREE DIFFERENT ROUTES, THREE DIFFERENT OUTCOMES

<table>
<thead>
<tr>
<th></th>
<th>CELLAR A</th>
<th>CELLAR B</th>
<th>CELLAR C</th>
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</thead>
<tbody>
<tr>
<td>Strategy/business model</td>
<td>'Anonymous bulk' supplier; long term contract</td>
<td>'Branded bulk'</td>
<td>Own brand; box wine</td>
</tr>
<tr>
<td>No of Members</td>
<td>16</td>
<td>63</td>
<td>203</td>
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<tr>
<td>Investment last 20 years (R mill)</td>
<td>16,3</td>
<td>75</td>
<td>254</td>
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<tr>
<td>Drinking wine %</td>
<td>99</td>
<td>61</td>
<td>90</td>
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<tr>
<td>% Packaged/Bottled</td>
<td>2,5</td>
<td>3</td>
<td>87</td>
</tr>
<tr>
<td>% Bulk</td>
<td>97,5</td>
<td>97</td>
<td>13</td>
</tr>
<tr>
<td>% Exports</td>
<td>0</td>
<td>50</td>
<td>15</td>
</tr>
<tr>
<td>Own vs Loan Capital</td>
<td>23% : 77%</td>
<td>56% : 44%</td>
<td>30% : 70%</td>
</tr>
<tr>
<td>Quick ratio (cash flow)</td>
<td>0,11 : 1</td>
<td>1,71 : 1</td>
<td>0,8 : 1</td>
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</tbody>
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WHAT DOES IT TELL US?

• Cellar C which developed its own brand, does its own packaging and distribution, i.e. the most value adding, is not in the best financial position

• Nor is cellar A, which supplies ‘anonymous’ bulk, plays it safe, but is in a position of dependence on two local clients

• The one doing best is cellar B, which is neither dependent on a few clients, nor has it committed itself to capital investments on the scale of cellar A; it is not ‘path dependent’
Instead it does business (mainly) in the ‘branded bulk’ market, where margins are small, but stable, and turnover is quick.

What the case studies show, is that economic performance has less to do with the nature of the cooperative, but more with the business model.

In a sense, what matters is not the ‘pool’, but how you sell it.

‘Improving quality’ through value adding requires big capital investments – something which most SA producer cellars do not have.

But even if they did, the return on investment is doubtful, given the price-cost squeeze in the industry.

Because what is at stake is not only increased costs in the vineyard and cellar, but also the ‘intangibles’ involved in launching a brand, creating the channels, promotion etc.

So perhaps the more viable route to ‘improved quality’ is ‘branded bulk’, for which there is a growing market.

Plus ‘cost leadership’

Another way to a ‘better deal’ could be to convert to a genuine company, gain in efficiency, open the business to outside investors, whilst jettisoning poor quality producers.

However, in such a case the original members of the coop would not only run the risk of losing control, but ironically would stop being a coop altogether.

Thank you