

# Which Way is "Up" in Upgrading? Trajectories of Change in the Value Chain for South African Wine

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## **Which Way is ‘Up’ in Upgrading? Trajectories of Change in the Value Chain for South African Wine**

Final version

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# Which Way is ‘Up’ in Upgrading?

## Trajectories of Change in the Value Chain for South African Wine

**Summary.** – Global Value Chain (GVC) analysis uses the concept of upgrading to highlight paths for developing country firms to ‘move up the value chain’, usually through the lenses of four categories – product, process, functional and inter-sectoral upgrading. The implicit normative expectation is that these firms move towards producing higher value-added products and/or take on more sophisticated functions along a value chain. In this article, upgrading is approached more broadly as ‘reaching a better deal’, including a balance between rewards and risk. The case study of South African wine shows that better product quality, improved processes and some functional upgrading have co-existed with processes of ‘downgrading’, higher risks and limited rewards, especially in traditional export markets. A reflection on further conceptual development and directions for empirical research is also provided.

*Key words* – upgrading, Global Value Chain (GVC) analysis, wine, South Africa

### 1. INTRODUCTION

Upgrading is often seen in the development literature as one of the main ways through which developing country firms or industries can respond to the challenges of globalization and increased competition. In the Global Value Chain (GVC) framework, upgrading is linked to a combination of making better products, improving processes to make these products, and/or taking over new functions. The implicit normative expectation is that developing country firms follow a ‘high road’ to upgrading, one eventually leading to performing functions in a value chain that have more skill and knowledge content ([Gereffi, 1999](#)). At the same time, recent empirical evidence points to a more complex set of upgrading trajectories ([Gibbon, 2001](#); [Giuliani, Pietrobelli & Rabellotti, 2005](#); [Schmitz, 2006](#)). Some of these

trajectories, particularly in Africa and in agro-food value chains, suggest that volume, economies of scale, and dynamics that would otherwise be termed ‘downgrading’ in the GVC literature may co-exist with ‘traditional’ upgrading paths for developing country firms (Gibbon & Ponte, 2005). This is especially the case where these firms operate in increasingly competitive environments and with escalating demands from Northern retailers and branded manufacturers.

One of the objectives of this article is to clarify what GVC analysis is trying to achieve with the concept of upgrading. There are two broad orientations within the literature. One relates to identifying the *sources* of capabilities that lead to accessing new markets and to increasing competences, a long-standing bone of contention between those privileging locational and institutional knowledge transmission and those focusing on transmission via buyer-supplier relations. A second orientation is more explicitly concerned with ‘development’ in terms of examining what conditions and trajectories can lead to ‘a better deal’ for developing country firms within GVCs.

Our interest in this article is in the second set of issues, with some focus on examining the combination of rewards and risk that follow certain paths of upgrading. This entails a *broader* take on upgrading that includes any trajectory or strategy that is likely to yield a positive impact on developing country firms – and contrary to Morrison, Pietrobelli & Rabellotti’s calls for a more precise notion of upgrading as ‘innovation producing an increase in the value added’ (2008, p. 45). At the same time, we agree with them that ‘going up the value added ladder’ is only one of the possible trajectories of upgrading, and that efforts to build and deepen capabilities at the same stage of the value chain are also important. However, the source of such deepening does not only reside in narrowly-defined ‘innovation’, but also in more general exposure to different managerial models, different end markets, and increased demands placed by retailers on time-to-market, packaging materials and/or food

safety standards. Upgrading (intended as a ‘better deal’ for developing country firms) may also arise as a result of *abandoning* innovations developed within a firm or cluster to accommodate buyer demands and/or changing consumption trends.

Empirically, we examine the South African wine industry.<sup>1</sup> This case study is particularly instructive because the wine industry, in the *apartheid* era, was for all practical purposes insulated from the demands of international markets (and buyers) for decades. With the opening of the export trade in the early 1990s, the industry was faced with a hitherto unknown set of demands on product qualities, styles, processes and logistics that differed dramatically from what it had been accustomed to. This, and the relatively minor importance of international regulation on the functioning of the wine GVC, provides an appropriate ‘laboratory case study’ to examine upgrading trajectories in isolation from other (non-GVC) determining factors.

The focus in this article is on upgrading trajectories, while an analysis of governance in the South African segment of the wine GVC is available elsewhere ([Ponte, 2007b; 2009](#)). For upgrading trajectories, we mean the combination of various and sometimes contrasting dynamics in the South African wine industry as a whole. In this perspective, industry upgrading results from the aggregation of firm-level changes. While individual firm experiences with upgrading would be a worthy objective of examination, space limitations do not allow such an analysis here. In this article, empirical evidence is presented quantitatively when industry-level data on appropriate indicators are available (on some aspects of product upgrading, for example). In relation to process upgrading, however, little aggregate data are available at the industry level. But the trends emerging from interview data are so clear that we chose to present them as a relatively coherent story, rather than breaking down its various aspects and providing a frequency count of our interview material. As concerns functional upgrading, where there are substantial differences among different kinds of operators, we do

provide frequency counts when appropriate. For some aspects of upgrading, there are simply no reliable indicator or comprehensive data, and one has to rely on qualitative statements by industry actors (for details on fieldwork and distribution of interviews among different kinds of actors, see endnote 1).

The rest of this article is organized as follows: the next section engages in the current debates on upgrading in GVCs with specific reference to developing countries, followed by a section presenting a brief profile of the South African wine industry. The following three sections examine the dynamics of product, process and functional upgrading in South African wine. The last section explains the relevance of the case study findings for both empirical and conceptual discussions of upgrading in GVCs.

## 2. UPGRADING IN GLOBAL VALUE CHAINS

In the GVC literature, the term upgrading has been often used to highlight paths for developing country producers to ‘move up the value chain’. The upgrading process is examined through the lenses of how knowledge and information flow within value chains from ‘lead firms’ to their suppliers (or buyers) ([Gereffi, 1999](#)). In this perspective, upgrading is about acquiring capabilities and accessing new market segments through participating in particular chains. The main GVC argument is that upgrading in various forms can be effectively stimulated through learning from lead firms rather than through (or in complementarity with) interactions between firms in the same functional position (horizontal transfer in clusters) or within the frameworks of common business systems or national systems of innovation. The recent literature on clusters has been specifically concerned with assessing which paths and aspects of upgrading originate from socio-spatial dynamics and which ones can be attributed to ‘learning from global buyers’ (most recently, see Giuliani, Pietrobelli & Rabellotti, 2005; Murphy, 2007).

Both the cluster and GVC literatures have often used a classification of upgrading based

on four categories ([Humphrey & Schmitz, 2002](#); [Schmitz, 2006](#)):

- (1) *product* upgrading: moving into more sophisticated products with increased unit value;
- (2) *process* upgrading: achieving a more efficient transformation of inputs into outputs through the reorganization of productive activities;
- (3) *functional* upgrading: acquiring new functions (or abandoning old ones) that increase the skill content of activities;
- (4) *inter-sectoral* (or inter-chain) upgrading: applying competences acquired in one function of a chain and using them in a different sector/chain.

The early GVC literature on upgrading ([Gereffi, 1999](#)) clearly privileged functional upgrading over other kinds. More recent contributions have highlighted the links between different forms of GVC governance and the possibilities for upgrading, particularly functional upgrading. This literature suggests that in chains characterized by what Schmitz (2006) calls ‘captive’ relationships, significant product and process upgrading by ‘local producers’ takes place (often with the active support of buyers). At the same time, functional upgrading is either discouraged or limited to some functions but not others ([Bair & Gereffi, 2001](#); [Gibbon 2002](#); 2008; [Giuliani, Pietrobelli & Rabellotti, 2005](#); [Schmitz & Knorrige 2000](#); [Schmitz 2006](#)). Thus, the ‘high road’<sup>2</sup> to upgrading is either not followed or is taken only part of the way. When it is followed, its rewards may be unevenly distributed and/or have a limited timeframe (see [Bair & Gereffi, 2003](#); for a successful example, however, see [Tokatli, 2007](#)). In chains characterized by market-type transactions, functional upgrading is more likely to take place, together with the transfer of new capabilities to different value chains ([Bazan & Navas-Aleman, 2004](#); [Schmitz, 2006](#); [Tewari, 1999](#)). The knowledge for this to happen (market, customer preferences, design, etc) seems to accrue in relationships with smaller buyers and/or domestic markets. However, the kind of investment needed in design, branding

and marketing is more likely to be available to firms based in developed countries or more advanced developing countries than in least-developed countries.

Although helpful as a starting point, there are numerous difficulties in working with the 4-type classification of upgrading highlighted above. *First*, it is sometimes difficult to distinguish product and process upgrading, especially in agro-food products, where the introduction of new processes generates new categories of products (e.g. organics, ‘sustainable’ products). *Second*, process upgrading, narrowly defined as increased efficiency between input and output through improved technological capabilities and innovation, does not explicitly recognize the importance of matching standards that are set by buyers and/or are embedded in import country regulations. Conforming to food safety standards (to comply with EU regulation, or ISO 22000 certification, for example) or applying environmental management procedures (for ISO 14000 certification) implies ‘improving’ production procedures, but not necessarily in more efficient (or cost effective/profit maximizing) ways. Also, matching food safety, technical or socio/environmental standards may indeed lead to products with ‘better intrinsic qualities’, but these are not necessarily of higher-value to the producer (product upgrading as defined above) – more often than not, matching standards is a condition of market entry (or a re-configuration of market entry) than a trigger for higher prices paid for a ‘better’ product, especially in buyer-driven value chains dominated by retailers.

*Third*, product and process upgrading trajectories, if applied to the production process alone as often is the case, do not explicitly capture other venues of ‘doing things more competently’ that are increasingly necessary for benefitting from value chain participation, such as matching strict logistics and lead times (time-to-market) and delivering supplies reliably and homogeneously time after time (a major challenge in agro-food products). *Fourth*, in some value chains, the ability to provide a portfolio of related products is an



important aspect of upgrading – it is not necessarily more numerous *value added* products that are needed in these portfolios, but a large range of products with different specifications that cover the whole range of quality and/or origins (e.g., wine portfolios representing all major regions, varieties, and price points); sometimes higher quality can actually be the entry window for creating profitable portfolios that include lower quality/ higher volume offerings (the success of wines such as Australia’s Penfold is based on a flagship wine that ‘carries’ lower ranges wines as well). At the same time, this strategy can entail high overheads and the risk of being out-competed on quality and/or price.

*Fifth*, economies of scale are still important to operate profitably in value chains; these do not only accrue from process upgrading, but also from simpler sources such as aggregating orders to increase the volume of sales (for example, creating a single export and marketing agency for a variety of wine producers). This can actually entail product ‘downgrading’ in the sense that lower value products sold in larger amounts may be the most profitable strategy for some firms, at least in the short term ([Gibbon & Ponte, 2005](#)). Furthermore, a ‘better deal’ for developing country firms may be reached without going through any of the four ‘traditional’ upgrading trajectories highlighted above: aggregation of orders can itself lead to securing more remunerative and/or longer-term contracts; similarly, fair trade certification (or an indication of geographic origin) can lead to a higher prices at the producer level without necessarily changing the intrinsic quality of a product, or radically modifying production processes. At the same time, product downgrading per se is unlikely to be a profitable strategy in the long run. When demand for a ‘basic’ product (which is very price sensitive) shrinks, producers are not likely to shift into a higher quality product segment (with lower price-elasticity) because they have not accumulated the capabilities to perform in such a segment. Instead, producers who have upgraded their products can still maintain their higher end markets, while they can use their profile for selling lower-quality, large volume products as

well.

*Finally*, the status of ‘inter-sectoral’ upgrading is unclear, as it relates to a trajectory of upgrading, while the other three categories describe what aspect of a given business is being upgraded; furthermore, the literature sometimes refers to ‘inter-chain’ upgrading when it actually means learning that is taking place in one strand of a value chain (e.g. the strand of a value chain oriented towards domestic consumption) that is applied to another (e.g. the strand of a value chain oriented towards export).

For the sake of continuity with the previous GVC literature, in the next sections we still interpret the changes that have taken place in the wine industry in South Africa through the lenses of upgrading, albeit in a critical manner. We do not take a normative view that the appropriate trajectory is the ‘high road’, nor that upgrading is necessarily related to value added products or functional upgrading in any pre-specified form. Furthermore, we take into consideration the balance between rewards and risk as a desirable outcome, to the extent that the data allow.

### 3. SOUTH AFRICAN WINE: A BRIEF SKETCH

In international wine circles, South Africa is classified as a ‘New World’ producer, along with Australia, New Zealand, Chile, Argentina and the US. South Africa is also seen as a new player in international wine markets, due to the recent (re)opening of its export markets and the end of sanctions with the transition to the post-apartheid regime of the early 1990s. This is somewhat misleading, as the first vineyards were planted in the Cape peninsula by Dutch settlers as early as 1655. Constantia wine was very popular in Europe at a time, and apparently a favorite of Napoleon. At the beginning of the 19<sup>th</sup> century, wine represented almost 90 per cent of exports from the Colony (Vink, Williams & Kirsten, 2004, p. 229). But by the end of the century exports had almost collapsed. In 1861, the UK – the main importer of South African wine at that time and again today – and France signed a trade agreement that

made French wines cheaper to import. The spread of phylloxera in the late 19<sup>th</sup> century destroyed most of the vineyard in the Cape (Ewert, Chiffolleau, Dreyfus, Martin, Touzard & Williams, 2002). In the early 20<sup>th</sup> century, the new giant co-operative, the ‘Ko-öperatieve Wijnbouwers Vereniging van Zuid-Afrika’ (KWV) was granted the statutory powers to regulate the industry. KWV controlled sales and stabilized prices, and later managed a quota system regulating new plantings, varietal choices and vine material imports. This period was characterized by a focus on high yields and volume over quality, and an overall preference for the production of brandy and fortified wine. Throughout the 20th century production (and presumably consumption) increased right until the advent of the new ‘quality era’ in the early 1990s (Williams, 2005).<sup>3</sup> Exports, on the other hand, fell to an all-time low in the late 1980s (Vink, Williams & Kirsten, 2004, p. 236). However, they had never been more than a minor part of total output. In 1988, they represented only 0.8 per cent of total output, compared to 5.1 per cent in 1964, for instance. Table wines, in turn, formed only a small proportion of total exports. Whatever was exported in the form of table wine, was done so by the KWV, in accordance with its export monopoly. As a result, very few South African growers or cellars had any experience of foreign markets when the KWV’s regulatory powers came to an end and sanctions were lifted in the early 1990s.<sup>4</sup>

It was only in the 1990s that a veritable renaissance of the industry took place – following the opening of international markets, the (relative) novelty of South African table wine, and a weak Rand. These processes continued until the early 2000s. However, by 2005, with the Rand strengthening and the start of a red wine ‘glut’ in the global market, the outlook had started to change.<sup>5</sup> In 2006, the industry witnessed decreasing exports, some bankruptcies, and a general decrease in profitability and competitiveness.<sup>6</sup> Signs of recovery were detectable in 2007 and 2008 with a new weakening of the Rand.

South Africa is not a major player in the global wine business, although it is important as a source of imports in selected countries.<sup>7</sup> In 2004, it accounted for under two per cent of the world surface area under vines, and for 3.3 per cent of the world production of wine (SAWIS, 2007, Table 12.1). This makes South Africa the 9<sup>th</sup> world producer, far behind France, Italy, and Spain, which have shares of 14-19 per cent each. But the wine industry is an important contributor to the economy of the Western Cape region. Perhaps even more important than the direct economic impact on employment and foreign exchange generation is the unique position of wine and wine tourism in generating images of South Africa abroad. It is therefore surprising that this industry has been the subject of a relatively limited academic literature,<sup>8</sup> and no attempt has been made to make sense of the challenges faced by the wine industry in South Africa through the lenses of upgrading.<sup>9</sup>

#### 4. 'PRODUCT UPGRADING'

As mentioned above, we take a broad view of product upgrading in this article. We recognize that there are important overlaps between product and process upgrading, and we do not take the normative view that product upgrading necessarily means increasing the value added (or the complexity) of a product. Other aspects such as volume, consistency, and/or a diversified product portfolio, may be as important, and sometimes even more, than increasing complexity or achieving a higher unit price per se. Furthermore, there are sector-specific constraints to the types of product and process upgrading that can take place in wine. 'New' products in the wine industry have a clearer lineage to existing ones than in other sectors (such as electronics, for example).

A 'traditional' GVC reading of *product* upgrading in South African wine in the last 15 years would provide a quite positive picture (see summary in Table 1). Intrinsic quality improved, exports took off, the proportion of bottled exports (*vis à vis* bulk exports) also increased (at least in the 1990s), the proportion of red varieties and of 'noble varieties' (in

both reds and whites) grew, a larger number of top quality wines became available, and sales of wine under the Wine of Origin scheme increased. In other words, the South Africa industry is now providing the international markets with wines of higher average quality, the right styles and alcohol content, and the right varieties as never before. Such a picture would fit with recent accounts of upgrading in wine industries in Argentina and especially Chile ([Artopoulos, Friel & Hallak, 2007](#); [Giuliani & Bell, 2005](#); [Gwynne, 2008](#); [Visser & de Langen, 2006](#)).

However, once rewards and risk are factored in the discussion, the assessment becomes more nuanced. Unit prices have increased only slightly (see below). Varietal risk has increased as Chenin Blanc production has decreased dramatically. Chenin Blanc is a resilient grape variety that can be used to make very different styles of wine (and for distilling wine if necessary), thus providing a degree of flexibility to grape farmers. Conversely, the failure to plant more red varieties (held to be problem by wine industry consultants until recently, due to increasing international demand for reds) has been a boon for the industry – as the red wine glut unfolded in the last few years. Furthermore, the risk related to high reliance on a few end-markets (and especially the UK) has not decreased sufficiently – export destination diversification is still limited.

Other indicators show a mixed picture of product upgrading, broadly defined: first, the industry has not grown much in terms of total volume of production, although consistency, aggregation of orders and logistics have improved; second, its make-up in terms of production of wine, rebate/distilling wine and non-alcoholic has not changed much, which is not necessarily bad if one takes risk into consideration, but would be read as a failure from a value added perspective; third, the growth of ‘wine of origin’ certifications has been satisfactory, but only in relation to generic geographic origin, not more specific ones. In the

next sub-sections, we will take each of these aspects in turn and provide some evidence to back the claims summarized in Table 1.

TABLE 1 ABOUT HERE

*(a) Unit prices*

A ‘traditional’ reading of successful product upgrading suggests that unit prices need to increase. This may well be the case. However, prices also depend on how buyer power plays out in a particular GVC, and on the dynamics of competition from other suppliers. More complex products (and processes) may indeed be rewarded with higher prices. At the same time, participation in GVCs may entail getting the same price for a better product – for the sake of maintaining one’s position in the face of increasing competition. No statistics are available on unit export prices of wine from South Africa,<sup>10</sup> but some indications can be drawn from average retail price changes in South Africa’s main export market, the UK. Here, South African wine has not yet been able to ‘break the GBP 5 barrier’ (on average) in the retail market, above which margins are generally healthier.<sup>11</sup> Another useful indicator is South African average prices for bulk wine (see Table 2).

TABLE 2 ABOUT HERE

Unit prices increased in the 1990s (but with a slow patch in the late 1990s), and especially in the early 2000s (between 2000 and 2003 by a cumulative 78 per cent) (SAWIS, various). But following the global red wine glut that started in 2004 and continued in the following two years, prices for red varieties plunged dramatically (by 36 per cent between 2003 and 2006; see Table 2) – this is not surprising, as the industry has been urged to plant more reds continuously in the last decade (along with what was happening at a grander scale in Australia). Conversely, prices for white varieties have increased in the 2000s. The price for ‘rebate wine’ (used for brandy production) has almost doubled from 2000 to 2006, and the price of distilling wine increased by almost 50 per cent, with a number of growers reporting to

the authors that they had downgraded their farming practices in some plots to harvest higher volumes of lower quality grapes to be sold for distilling wine because it was more profitable. From the point of view of producers, in certain circumstances, ‘downgrading’ can indeed pay off.

*(b) Trends in production, varietal composition, exports and packaging forms*

The total area planted under wine grape vineyards has expanded dramatically over the last decade in South Africa, from 85,000 ha in 1996 to over 100,000 ha in 2004 (SAWIS, 2007, Table 5.3). South Africa has a far higher proportion of production of white grape varieties (62 per cent of total volume) than other New World countries such as Australia, Chile and the USA, even though production of reds has increased since the end of *apartheid* (SAWIS, 2007; see also Table 3). South Africa is also producing a higher proportion of ‘noble varieties’ of higher quality (such as Chardonnay, Sauvignon Blanc, Cabernet Sauvignon, Shiraz, Merlot, and Pinotage) than in the past. As recently as 1999, almost 27 per cent of total area was planted with Chenin Blanc, a white variety that has been for a long time the ‘workhorse’ of the industry – appreciated for its resilience to stress and its adaptability for production of different styles of wine (for distillation, dry, semi-sweet, sweet, and sparkling). The second largest planting was Colombard (13 per cent of total area), a white grape mostly used for cheap blends and for distillation. Noble varieties represented only 2-6 per cent of total planted area each, for a total of 34 per cent of the total planted area (SAWIS, 2007). In 2006, the picture looks remarkably different: Chenin Blanc is still the most widely planted variety, but represents only 19 per cent of the total. Cabernet Sauvignon follows suit with 13 per cent, Shiraz has a 10 per cent share, and Chardonnay and Sauvignon Blanc around 8 per cent each. All together, noble varieties make up around 53 per cent of the total planted area (SAWIS, 2007; see also Ponte, 2007a).

TABLE 3 ABOUT HERE

In 1996, table wine *exports* represented only 17 per cent of total sales (by volume) as the industry had just started to gear up for the international wine market following the end of sanctions (see Table 3). South Africa was highly reliant on the UK for its exports (44 per cent of the total), while the Netherlands, Germany and Scandinavian countries accounted for around 7-8 per cent of exports each. By 2005, exports had increased almost four-fold to over 270 million liters (or 47 per cent of total sales by volume), of which over one-third went to the UK (three-quarters in bottles and the rest in bulk) (see Table 4). The Netherlands was the second destination with 17 per cent of total exports, followed by Germany with 13 per cent and Sweden with 7 per cent. Together, these four destinations accounted for over three-quarters of the volume of wine exports in 2005, although exports to the USA, a potentially important destination for higher quality wine, were growing.<sup>12</sup>

TABLE 4 ABOUT HERE

The packaging form in which wine is exported, after showing signs of upgrading in the 1990s has now reversed its trajectory. Table 4 shows that 66 per cent of total exports were in the form of packaged wine in 2005 (a 'good' indicator from a traditional upgrading perspective). The large majority (around 80 per cent) of packaged exports were in glass bottle, with the remaining part in bag-in-box and a minor volume in tetra-pack. The remaining 34 per cent of total exports were of bulk wine. Although the current proportion of packaged exports is higher than in the late 1990s (in 1997, they represented 59 per cent of exports), between 2002 and 2004 it was substantially higher than now (and always over 69 per cent). In other words, bulk exports (especially to Germany, where they account for over half of the volume of exports) have increased during a period of price contraction in international markets, furthering a downward pressure on local production prices. Although exports recovered in 2007, the proportion of packaged exports continued to decrease, accounting to slightly over 61 per cent (SAWIS, 2007).



*(c) Alcohol levels, icon wines and 'wine of origin'*

An area where precise statistical information is lacking is the alcohol content of the average South African wine. Yet, many in the industry agree that the average level has increased visibly in the last decade, from 12.5-13 to 14-15 per cent especially for reds (see also Lloyd, 2005). More powerful yeasts and better vine material are part of the reason, but also evolving winemaking styles, and the search for riper, more concentrated wines with higher alcohols to appease, depending on the wine segment, wine judges or the perceived fruit-forward preference of Anglo-Saxon consumers (see also Matthews, 2004). In parallel to this, the number of South African top quality wines with a high reputation in international markets has increased. Both of these can be considered positive in terms of product upgrading.

The quantity and proportion of 'certified wines' (according to the Wine of Origin scheme, see below) that are examined by the Wine and Spirits Board (WSB) has also increased dramatically, from 25 per cent of total wine production in 1999 to over 50 per cent in 2006 (SAWIS, 2007, Tables 6.5 & 6.6). This reflects the increase in exports, for which certification is mandatory. However, of the 331 million liters certified in 2006, a majority (66 per cent) specified only the broad geographical unit. Other, and more specific, origins under the Wine of Origin scheme applied to 31 per cent of total certified wine, while estate wine accounted for only 2.5 per cent of total certifications.

*(d) Volume and consistency*

Although the total volume of production has remained fairly constant in the 2000s, South Africa is regarded by importers and in industry publications as having improved in consistency and timely delivery of homogenous, basic quality wine. Sometimes, this has implied an outright downgrading process, as the increase in bulk exports to Germany and the Netherlands of the last few years suggest. But volume is absolutely essential in price-sensitive

markets, and especially in the UK if one wants to run 2-3 retail-level promotions a year. Although private cellars have been instrumental in improving the number and volume of higher-quality wines, cooperatives and ex-cooperatives still crush 79 per cent of all grapes used for winemaking (SAWIS, 2006, Table 6.3). Along with a few producing wholesalers, they are the ones that can provide economies of scale, competitive pricing and large volumes of consistent quality. These are essential requirements for supermarket chains to place wines on the shelf (together with impeccable logistics).

## 5. 'PROCESS UPGRADING'

Some clear elements of *process* upgrading have also taken place in the South African wine industry (see summary in Table 5). Viticulture and winemaking operations have improved dramatically. But significant productivity gains can still be had if workers were trained differently and provided with better pay and incentives. The industry has embarked on a number of certification initiatives. However, many of the improved processes and obtained certifications are part of what is now expected as a given by retailers, and do not provide a competitive advantage, just potential entry into the market or maintenance of an established position. Perhaps the weakest improvements have been in branding and marketing. There seems to be a consensus amongst both local and international analysts that too many (co-operative) growers still have a production (instead of market) orientation and that South Africa has too few successful brands (for the UK market, see Table 6).

TABLE 5 ABOUT HERE

Another aspect related to process upgrading that has been less examined in the literature is achieving higher margins with the same (or similar) products by accessing higher-margin markets. In relation to South African wine, Sweden and the US have been the main targets of such an effort. The UK, despite being the main export market for South African wine, is considered by many a blind alley because large retailers are very demanding on logistics,

volume, promotional support and demand very competitive prices. Germany and the Netherlands, South Africa's export destinations number two and three are extremely price sensitive. The US and Sweden, for different reasons, provide a better perspective for South African exporters.<sup>13</sup> Yet, together, they constituted only slightly above 10 per cent of exports by volume in 2005 (see Table 4).

*(a) Managerial systems, viticultural and winemaking practices, and labor skills*

South Africa has made major strides in quality management (especially since the mid-1990s), both in the vineyards and in the cellars. These improvements have included: better styles; cleaner and more scientific winemaking; new technologies, such as micro-oxygenation and reductive handling; and management of vineyards increasingly on the basis of separate blocks, rather than on the basis of the whole vineyard (i.e. 'block grading').

Before the early 1990s, the regulatory system had reduced much South African wine to a characterless product. But, subsequently cooperatives started to differentiate their production, to make separate wine from different blocks and to vinify in different batches. Premiums on quality started to be paid to individual growers – unlike the previous era when a fixed price per volume was paid from the overall pool. Coops also started to employ full-time viticulturists as a liaison between members and cellar management – previously, these specialists were absent from the coop staff. Viticultural extension services were provided by KWV officials, giving advice, but working firmly within the parameters of the regulatory system, leaving little space for innovation.

In the second half of the 1990s, some cooperatives began the process of turning themselves into shareholder companies, primarily to introduce a 'business orientation' and to source equity capital on the open market. These companies are now owned by shareholders. In many cases (though not all) this has generated better individual returns, has established a stricter relation between price and the quality of grapes delivered, and has created pressure to

perform. Both cooperatives and ex-cooperatives now produce clean, fresh wine that has a stronger varietal character than never before. As a result of these improvements, cooperatives are able to supply a large proportion of South African wine for export, including all the top brands in the UK market. Without cooperatives, brands such as Kumala, Arniston Bay, Goyia, First Cape and Namaqua would not feature on UK supermarket shelves.

The production of better quality wine requires the implementation of particular technical measures in the vineyard, such as cultivar-terroir adaptation, vigor and yield control, and environment-friendly production. Cultivar-terroir adaptation is an essential element of the production of grapes for quality wines. As cultivars are often new and the terroir highly diversified, enterprises are forced to build up spatial data bases of various kinds, enabling the identification of plants' agronomic behavior and the oenological results of grapes according to their annual variability in the different parts of the vineyards (Carey, 2001). In addition, the control of plant vigor, i.e. the achievement of balance between growth and production, is the key factor in the concentration of berry sugar, aromas, phenolic components and other elements that are at the basis of successful production of high quality wines. Thus, it is crucial to monitor precisely the individual behavior of vines, which is highly variable, even in the same block, due to the strong heterogeneity of soils and altitude. This precise monitoring is meant to adapt each action on the vine to its actual needs (Archer, 2001). As a result, in the quality era, pruning, 'de-suckering', and other aspects of 'canopy management' have to be executed in accordance with the specific condition of the vines. The same goes for yield control. Moreover, environment-friendly techniques are increasingly defined as an additional attribute of quality.

Today in South Africa most growers, including the ones who belong to cooperative wineries, are aware of this. Awareness of the importance of site ('terroir') and the correct long-term and short-term vineyard practices has grown in leaps and bounds over the last ten

years or so. This new knowledge has been passed on by research institutions, the cellar's viticulturist, study groups, consultants, industry publications and fellow farmers. In the case of cooperative wineries, cellar management issues clear guidelines as to the vineyard practices that have to be followed if members want to achieve an 'A' classification of their grapes, for instance.

So, by and large, fifteen years into the 'quality' era, the main problem is not a lack of awareness or knowledge. If viticulture can still be improved, this may have more to do with farmers' production strategy than with a lack of know-how. In South Africa, 48 per cent of all growers produce less than 100 tons of grapes per year. In addition, most of the approximately 4,000 growers also cultivate fruit, citrus, vegetables, and/or wheat. Given this 'farming style', not all farmers necessarily aim to produce top quality grapes. According to a group of consultants ('Vinpro') who work closely with farmers, most cooperative growers follow a 'strategy of average [quality] production'.<sup>14</sup> Data from a Vinpro study shows that none of the most profitable farmers pursue a 'class A' wine grape strategy.<sup>15</sup> This is not only to spread the risk. Spending less labour and other inputs on a vineyard, but producing more tons of 'class B' grapes may actually be more profitable. In practice, the price differential that one gains producing wine grapes of class 'A' does not necessarily justify the higher input costs and lower yield it entails. This means that regardless of how much the cooperative management may urge its members to produce top quality grapes, it comes up against the growers' production strategy.

Whether growers aim for top quality or not, workers' skills have been upgraded on most farms over the last decade or so. They have been educated in new ways of pruning, canopy management and even disease control. Most of the training occurs on the job, combining 'theory' and practical application in the vineyard. More often than not training is not confined

to simple instructions, but is accompanied by at least an elementary explanation of why things are done in a certain way.

Although the average educational level of the labour force is probably not more than seven years of schooling (between 20 and 25 per cent are illiterate), there is evidence that most workers have adapted well to the new skill requirements. A study conducted in 26 cooperative farms in 2004 showed that even workers with a very low school education had a very good understanding of the farmer's instructions ([Brown-Lhutango, 2007](#)). Thus the challenge does not lie primarily at the cognitive level, but at the motivational level. Although a statutory minimum wage does exist, it is set at survivalist levels and scarcely acts as a motivator. Motivation is further inhibited by increased casualization of employment and a lack of mobility – both at the level of the farm and in the labour market. As a result, productivity is probably lower than in most of the classic 'old world' wine producing countries. Little trust that workers will execute tasks correctly and/or consistently coupled with intensive supervision also makes this management system a relatively expensive one.<sup>16</sup>

#### *(b) Certifications*

Over the last fifteen years the South African wine industry has succeeded in building and consolidating a quality assurance infrastructure which guarantees that certain *minimum* quality standards are adhered to. This infrastructure consists of a number of elements. Firstly, there is the Wine of Origin (WO) scheme. The WO scheme is a set of regulations that guarantees the origin, cultivar, and vintage of wines. Currently, all wines for export need to be certified under the WO scheme (NDA 2005), while wines for domestic consumption are only subject to these regulations if the producer wants to specify origin, cultivar and/or vintage on the label. The WO scheme is administered by the Wine and Spirits Board (WSB), which performs control functions and carries out sensory analysis of all batches of wine submitted for certification.

Secondly, there is the Integrated Production of Wine (IPW) scheme. The IPW is a semi-regulatory system that was introduced in South Africa in 1998. It provides guidelines for ‘Good Agricultural Practices’ for farms and ‘Good Manufacturing Practices’ for cellars to produce wines that are ‘healthy, clean and environmentally friendly’ (IPW 2004). The system is mainly regulated via self-monitoring.<sup>17</sup> Although compliance with IPW can be achieved by scoring only 50 per cent of the total score, it has done a lot in creating environmental awareness amongst South African growers and is expected to be made mandatory before 2010.

Thirdly, the South African wine industry has introduced or adopted a number of other voluntary standards and certifications, covering a wide array of aspects, e.g. labor conditions, production, processing, food safety, and quality management more generally.<sup>18</sup> Although great strides have been made at this level, one needs to keep in mind that many of the improved processes and obtained certifications are part of what is now expected as ‘a given’ by retailers.

#### *© Marketing and branding*

It is generally agreed that South African wine producers spend too little on marketing and advertising. Even fifteen years into the ‘quality era’, too many growers and cellars are still considered to be supply driven, whilst paying too little attention to market signals. Although there is still room for improvement in technical operations and in cost-rationalization, marketing is seen as the main way forward by strategy analysts, both at the industry and individual company levels (Loubser, 2001; Rabobank, 2004; [Wood & Kaplan, 2005](#)). In their view, not only price and quality are important, but also branding, developing a ‘personality’ for a wine, ‘lifestyle’ messaging and packaging. It is generally agreed that South Africa needs to build strong brands for mid-range quality wines sold over €7/£5 (i.e. the

segment that is growing fastest and where margins are healthier) if it wants to attract sizable foreign investment (Rabobank, 2004).

Due to the price wars that take place in the retail market in the UK, to be competitive a South African supplier needs to provide ‘above the line’ support, such as print and media, and ‘below the line support’, linked to point of sale and consumer promotion. A key feature of the UK retail wine market is that much of the volume of sales in supermarkets takes place during promotions – with some brands such as Constellation’s Banrock Station and Hardy’s selling upwards to 80 per cent on heavily discounted terms (see Ponte, 2007b; 2009).

Smaller wine companies are increasingly unable to meet retailers’ expectations and demands (this is true of agro-foods and consumer goods in general). It is difficult enough to score a listing with a major retailer. Once there, listing fees are usually charged, sometimes as a fixed amount and other times as a proportion of sales. Wine companies can be asked to make payments for shelf-space, and expensive ones for end-of-aisle promotions, or for mentioning a wine in the in-store magazine. In addition, retailers have started to purchase wine through ‘reverse internet auctions’, which further squeeze margins upstream in the value chain.

TABLE 6 ABOUT HERE

In relation to branding, South Africa is seen in the UK wine trade as lacking in the number of big brands that are needed to drive significant growth. It is seen as too dependent on Kumala, which has seen stagnant sales. Other brands of South African wine, however, are growing healthily, such as Namaqua (from giant ex-cooperative Westcorp, recently renamed Namaqua) and FirstCape (from a joint venture of several cooperatives and BrandPhoenix of the UK). The most successful brands of South African wine in the UK are now owned or co-owned by UK companies (see Table 6) – while the market share of traditional South Africa-owned brands has remained fairly stagnant in the UK, with a few exceptions.



As far as generic marketing of ‘Brand South Africa’ is concerned, the organization responsible (i.e. WOSA – Wines of South Africa) has since 2004 embarked on a marketing initiative called ‘Variety is in our Nature’. The idea is that the enormously rich biodiversity of the Western Cape can be translated into a great variety of wines, and conversely that appropriate stewardship of the winelands can preserve this biodiversity. This commitment is showcased in the Biodiversity and Wine Initiative (BWI) and in the integration of biodiversity guidelines in the IPW scheme (see above). In practice, this means that before planting new vineyards, producers need to carry out a botanical audit and draw up a plan to preserve endangered and significant species. Some producers have set aside natural areas that will remain undeveloped in perpetuity (WOSA, 2005, p. 11).<sup>19</sup> However, this initiative is fraught with all kinds of reservations and contradictions and, as a result, does not have the support of the whole industry.<sup>20</sup> For one, WOSA’s motto sits rather uncomfortably with two facts: first, that grape growing is a mono-crop cultivation method that destroys rather than enhances biodiversity (Schmitt, 2005, p. 67); and second, that the industry is not diverse in its *human* nature, especially at the managerial and ownership levels.<sup>21</sup>

## 6. ‘FUNCTIONAL UPGRADING’

In order to explain functional upgrading (or downgrading), we first provide a simplified picture of the functional division of labor in the value chain for South African wine as reflected in the kinds of grape and wine procurement systems operated by private cellars, producer-wholesalers and marketers. In Figure 1, we represent the mix of these systems as we move down on the quality pyramid of South African wine. The divisions in the pyramid are not as clear-cut as the graphic representation suggests – overlaps and a combination of other systems also apply. Our interview material suggests that, across the quality range, operators are generally striving to move away (totally or partially) from systems sitting at the top of each pyramid segment and towards those sitting at the bottom.

FIGURE 1 HERE

This is not the place to examine procurement systems in detail (see Ponte, 2007b). But for the purpose of our discussion on upgrading, we wish to highlight three observations. The first is an ongoing process of shedding off upstream functions closer to the production level. When complete outsourcing is not possible, operators across the board try to move from hands-on management systems (requiring close supervision) to more hands-off systems, with the exception of top quality wines. All small and medium-scale wineries (those producing under 250,000 nine-liter cases of wine per year) rely to some degree on own-grape growing and always make their own wine. Of the 14 small and medium scale wineries we covered in our fieldwork, only four were roughly self-sufficient in grapes, while eight wineries were selling and/or buying significant amounts of grapes. Two cellars relied only for a small proportion on their own vineyard and bought-in most grapes from contracted farmers. All cellars but five reported an increased reliance on buying-in grapes from contracted farmers. Normally, they use their own grapes for making higher quality wines, and bought-in grapes for lower quality (they may also buy in grapes of higher quality if they fail to produce enough volume on the farm). Five cellars also bought-in ready-made wine (from other cellars or cooperatives), usually for cheaper blends.

We also interviewed all the top six producer-wholesalers in the country and eight marketers (including the top four) – all together these 14 firms account for the bulk of wine exports from South Africa (of all quality ranges). All marketers, by definition, do not grow grapes or make their own wine – they rely on contracted wineries (often producer cooperatives). But even the largest and historically most important producer-wholesalers are now moving away from grape growing on own farms (one of the top two is down to owning only one farm) and in some cases even winemaking – thus becoming pure marketers. In the case of outsourcing of winemaking, the trend is clearer among more recently-established

players, but less so in relation to top quality wines – where these companies want to keep more control over the winemaking process. Large cooperatives (or ex-cooperatives) do not have outsourcing options because their members are grape growers. As a result, they are increasingly holding stock (and facing higher risks) on behalf of others in the value chain. This was reported by all twelve cooperatives and ex-cooperatives we interviewed (representing almost one-third of wine production in South Africa in 2005).

What we have described so far is a classic vertical disintegration process, where many private cellars and producer-wholesalers are moving away from grape-growing. Alternatively, they are reducing their engagement in grape-growing, or engaging in it in more hands-off ways (see Ponte, 2007b). Some of the most successful producer-wholesalers have largely moved away from winemaking as well, thus divesting from holding fixed capital.

TABLE 7 ABOUT HERE

The second observation we want to highlight is that international wine marketers and drinks conglomerates have not made substantial investments in South Africa, with the possible exception of the recent purchase of Flagstone winery by Constellation (which now owns Kumala as well). However, Flagstone is a cellar without land – it buys-in grapes from contracted farmers. Other major moves by large overseas drinks conglomerates and brands (for example, by Pernod-Ricard, Constellation/Kumala, Gallo, Foster/Lindeman, Diageo/Blossom Hill) have been based on marketing and branding agreements, not on developing or taking over vineyards and cellars.

The first two observations we made so far actually run contrary to what has happened in other producing countries in the Southern Hemisphere ([Gwynne, 2006; 2008](#)), where a process of vertical integration is taking place domestically, and where foreign investment has been substantial. According to Rabobank (2004), South Africa has failed to attract major foreign direct investment in the wine industry so far because: (1) the industry is too

fragmented; (2) South Africa does not have strong brands in the premium segment of the market (€5-7) – the segment that is growing fastest and where margins are healthier; (3) South Africa’s strength in the popular premium segment (€3-5) does not allow large investments due to the small margins available in such segment; conversely, investments in super and ultra premium wines, where the country is well represented, are relatively too small in scope for large foreign investors (although smaller investments have taken place, often in the form of joint-ventures); and (4) the perceived political and currency risks in the country. The second and fourth factors are often mentioned in the wine trade literature as well.

Our third observation on functional upgrading is that the few South African producer-wholesalers and marketers who used to have their own agencies in the UK and Europe are either divesting from them or entering in joint-ventures with Europe-based branders and marketers. As mentioned above, many of the most successful brands of South African wine in the UK are owned or co-owned by overseas companies (see Table 6). These are processes of functional downgrading from a point of view of South African producers – yet, they have yielded positive results at least in terms of ‘moving volume’ .

Conversely, about half of the cooperatives and ex-cooperatives we interviewed have become more engaged in direct marketing and branding through joint ventures (which may also involve co-ownership of a brand, rather than just marketing agreements), some with very successful results (Goudini/FirstCape, Swartland, Westcorp/Namaqua). This is an example of functional upgrading on their part. UK agents and marketers also had to functionally upgrade. Under pressure from shorter lead times, they had to increase their control over logistics (some importers are now selling to retailers with delivery executed at the warehouse in the UK instead of ‘free-on-board’ on the ship in Cape Town). As retailers are seeing themselves increasingly as shelf-space providers, replenishment as a function falls upon UK agents. Much product innovation, new packaging, new presentations and styles are also generated by

these agents/marketers (see details in Ponte, 2007b; 2009). This does not mean that upstream learning is not taking place. Up to the early 1990s, quality in South African wine was ‘producer-generated’, while now cellars and South African marketers are able to interpret consumer market changes and react to downstream requests much more quickly and efficiently.

## 7. CONCLUSION

Major product and process upgrading and some functional upgrading have taken place in the South African wine industry over the last decade and a half. Throughout much of the twentieth century, the wine industry in South Africa was centered around co-operative wine cellars, which were responsible for a large proportion of total wine production, supplied bulk wine of low quality, and whose farmers were dependent on cheap black labor. Although some improvements had taken place before the end of *apartheid*, the industry has upgraded substantially since. This took place especially in the 1990s, with a less steep curve in the 2000s.

But the upgrading picture emerging from the South African case is more complex than just improved product quality, better processes and some functional upgrading. Such dynamics have co-existed with demands for higher volume of basic quality wines and increasing demands for bulk delivery (instead of packaged wine), shorter lead times, flexibility in delivering to buyer specifications, increased casualization of labor, and the provision of expensive promotional support. Demand-driven wine styles, volume and consistency have allowed the industry to grow in the basic quality segment of the industry, while the proliferation of higher quality wines has opened new niches. The package of specifications that are expected to be delivered ‘as a given’ has become increasingly demanding and sophisticated. While this has in turn stimulated further process upgrading in the form of vineyard practices, wine cellar innovation, better managerial practices, and more

systematized quality management, its rewards have been limited and some types of risk have increased. Furthermore, the margins for improvement have now decreased in many areas. The extras (e.g. promotional support) that need to be delivered to obtain or maintain a listing with major retailers are expensive. Margins remain extremely low in the retail markets of the UK, Germany and the Netherlands, the industry is still far from a visible presence in the more lucrative US market, and the domestic market is under-developed.

While the case study of wine in South Africa should not be taken prescriptively in relation to developing country participation in GVCs generally, it does suggest the importance of detailed study of the dynamics of specific value chains for understanding real-world patterns of upgrading. So, we argue, terms such as ‘process’, ‘product’ and ‘functional’ upgrading should be used only as partial guides to arrive at a more complex and fine-tuned picture of upgrading.

These observations have a number of consequences for future research and conceptual development on upgrading in GVC analysis. *First*, analyses of product upgrading should include effects on product quality that do not necessarily mean higher value added. Conversely, there may be strategies related to the product itself (forward contracts, volume premia) that can have beneficial effects without changing anything to the nature of the product itself. *Second*, process upgrading needs to include ‘improved’ practices (and related logistics, time-to-market, environmental management, food safety regulation, fair trade certification, etc) that do not necessarily make processes more ‘efficient’, but that can allow developing country players to improve their position in value chains or even just to maintain it in periods of restructuring. *Third*, both product and functional upgrading should include forms that traditionally would be conceived as ‘downgrading’ (moving down the value chain, producing/selling more basic products at larger scale), depending on what the best outcome for developing country firms is. The literature is replete with examples of how functional

upgrading can go wrong – it is expensive and risky, and the rewards are not necessarily clear (see [Gibbon & Ponte, 2005](#)). As for product downgrading, it is sometimes important as a means of securing a stable and profitable supplier position in ‘buyer-driven’ contexts, especially at times of strengthened competition among suppliers and if coupled with improved economies of scale. Bulk sales have actually allowed the survival of key segments of the wine industry in South Africa at times of crisis, making it possible to survive in the short run by reducing costs. At the same time, product downgrading may not be a profitable strategy in the long run. If producers downgraded out of necessity and/or only part of their production, they can still go back to higher quality production. Those who are producing only low quality do not have such an option and tend to be stuck in price sensitive and low margin segments of the market (in Europe, this is known as the ‘Aldi effect’, from the name of the large German discount chain). That is why process downgrading is seldom a good option.

In conclusion, GVC analysis should break away from normative views of upgrading as ‘moving up the value chain’ or as always producing ‘value added-products’, and embrace a view that a ‘better deal’ for developing country firms may entail sometimes processes of functional downgrading and periods in which even product downgrading may be the best option available. Additionally, the analysis of rewards and risk needs to be incorporated organically in the study of the outcomes of upgrading. Finally, and more fundamentally, if a ‘better deal’ for developing country firms entails more than just ‘moving up’ the value chain or embedding higher value into products, and is indeed characterized by a complex mixture of upgrading and trading down, does it still make sense to use the term *upgrading* in GVC analysis? If not, a new effort is needed to re-shape the conceptual and heuristic discussion on the matter.

## Notes

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<sup>1</sup> This article is based on material gathered through fieldwork carried out jointly by the authors in South Africa from June to November 2005. The fieldwork consisted of 99 interviews with 74 entities that are directly or indirectly involved in the production of grapes and wine, their processing and marketing, and/or related inputs and services. In terms of direct players, the main focus of fieldwork was at the marketing/exporting level and, to some extent, at the cellar level. We selected these entities through snowball sampling, and focused on covering the largest proportion of wine produced and marketed, rather than the largest number of actors *per se*. As a result, we interviewed all nine producers-wholesalers and marketers/exporters that sell more (or around) 1 million cases of wine per year were interviewed, plus five smaller ones (selling between 120,000 and 800,000 cases each). These 14 entities interviewed in total account for marketing almost 280 million liters of wine, or 44 per cent of the 2005 production of wine. In the category of private cellars, given the large number of cellars in operation, the aim was to cover a small number of medium-scale cellars (four, producing between 100,000 and 250,000 cases each) and of small-scale cellars or estates (ten, producing between 4,000 and 90,000 cases each). In addition to this, 20 per cent of existing cooperatives and ex-cooperatives were interviewed (twelve of them). The cooperatives covered in the study account for a production of around 180 million liters of wine, almost one-third of total production of wine in South Africa in 2005. In relation to grape growers, given the limited resources available, only a small group (ten) was interviewed to have a general idea of how contractual relations, quality assessment, and agronomic practices were changing. All three categories of growers were covered (in addition to private cellars who have their own vineyards): independent grape growers (without cellar facilities), growers that are part of a cooperative, and growers that are shareholders in an ex-cooperative. Finally, interviews were carried out with retail chains (three of the top four retailers in South Africa), local representatives of wine importers based in Europe, local wine writers and



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judges, providers of services to the industry, industry associations, and government entities that regulate the production, trade and retailing of wine. The identity of companies and individuals has been withdrawn to comply with a statement of confidentiality that was offered to interviewees.

<sup>2</sup> The ‘high road’ to upgrading is the movement from Original Equipment Manufacturing to Original Design Manufacturing to Original Brand Manufacturing, presented by Hobday (1995) and used by [Gereffi \(1999\)](#) in his work on the clothing value chain.

<sup>3</sup> See Shaw (2001) for a concise political economy of the wine industry in South Africa. For a much more detailed exposition of its history, see Williams & Vink (1999) and Vink, Williams & Kirsten (2004).

<sup>4</sup> Although sanctions did play a part in curbing exports, their effect is generally exaggerated.

<sup>5</sup> Much of the red wine glut can be explained by three successive high-quality, big-volume vintages in Australia. In 1998, there were under 100,000 ha under vines in Australia – by 2006, the area had increased to 167,000 ha. In 2006, Australia left 100,000 tons of unharvested grapes in its vineyards, more than the equivalent of South Africa’s domestic wine market (Fridjhon, 2006).

<sup>6</sup> According to studies of profitability among cooperative cellars carried out by PwC, net profit per ton went from ZAR 52 in 2004 to ZAR 29 in 2005. In 2006, they touched rock bottom at ZAR 5, before recovering partially to ZAR 31 in 2007. Source: PwC, ‘The SA Wine Industry – Benchmarking of Producer Cellars’ (2006 and 2007 harvests; published in 2007 and 2008 respectively).

<sup>7</sup> South Africa is the 5<sup>th</sup> exporter to the UK and is expected to become the top exporter to Sweden in the near future.

<sup>8</sup> Much of this literature has been generated by sociologists (and a few geographers) examining how the restructuring of the wine and fruit industries has impacted on labor

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practices at the farm level (du [Toit & Ewert, 2002](#); [Ewert & Hamman, 1999](#); [Ewert & du Toit, 2005](#); [Kritzinger, Barrientos & Rossouw, 2004](#)). A sub-component of this literature explicitly examines the impact of ethical trade initiatives and other ‘empowerment’ processes on both the actual conditions of labor on the farms and the space for maneuver for more radical policy options (Bek , [McEwan & Bek, 2007](#); [du Toit, 2002](#); [McEwan & Bek, 2006](#); [Nelson, Martin & Ewert, 2005](#)). Others have tackled the process of ‘Black Economic Empowerment’ and its actual and potential impact on the wine industry as a whole, and not only at the farm level (du [Toit, Kruger & Ponte, 2008](#); [Williams, 2005](#)).

<sup>9</sup> An emerging literature on upgrading in wine is available in relation to other New World countries, such as Argentina ([Artopoulos, Friel & Hallak, 2007](#); [McDermott, 2007](#)) and Chile ([Giuliani & Bell 2005](#); [Gwynne, 2008](#); [Visser & de Langen, 2006](#)). The focus in these contributions is on cluster vs. external dynamics of learning and innovation ([Giuliani & Bell, 2004](#)), cooperative and institutional mechanisms and politics of such dynamics ([McDermott, 2007](#); [Visser & de Langen, 2006](#)), and the role of ‘pioneers’ in fostering successful upgrading dynamics and the conditions under which this can happen ([Artopoulos, Friel & Hallak, 2007](#)). The closest the wine literature has come to a more conventional GVC approach to upgrading is in work by [Gwynne \(2008](#); see also [Gwynne, 2006](#)), where the analysis is limited to product and process upgrading.

<sup>10</sup> COMTRADE reports both value and volume of imports into the EU only for 2006 and 2007, not for previous years. Breakdowns on unit price exports from South Africa to the EU are not available either from SAWIS or from EUROSTAT.

<sup>11</sup> Source: *the drinks business* South Africa Report 2006.

<sup>12</sup> In 2006, due to a continued red wine glut, competition from Australia and Chile, and a strong Rand, exports contracted for the first time since 1994 (by 3.6 per cent). The fall was especially large in South Africa’s main markets – the UK and the Netherlands, only partially

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compensated by increased exports to Germany, which has now overtaken the Netherlands as the second largest importer of South African wine (SAWIS, 2007). In 2007, a weakening of the Rand and the smallest crop in Australia since 2000 helped exports from South Africa to recover.

<sup>13</sup> Sweden is a peculiar market because the monopoly agency (*Systembolaget*) buys on tender for its own off-trade market (sales outside bars, restaurants and catering). South Africa has experienced dizzying growth in Sweden (a 34 per cent increase in sales in 2005). The US is a market where South African suppliers see potential for growth, especially at the upper price points, and healthy margins. As one interviewee put it, ‘they allow you to make a profit! They understand the need for everyone to make money in the trade; this does not happen in the UK’. The US is a challenging market because of its fragmentation due to state-based regulations and a three-tier supply chain. In most states, importers, distributors and retailers are licensed separately, no actor can hold more than two of the three licenses, and most often only holds one. Unsurprisingly, the US market is much more fragmented than the UK market, with only three distributors handling over one million cases. But brand recognition is essential in the US, as are good scores from wine critics, even for wines that elsewhere fall in the category of ‘basic quality’.

<sup>14</sup> Personal communication, Gert van Wyk, Vinpro consultant, 15 August 2008.

<sup>15</sup> Personal communication, Francois Viljoen, Vinpro consultant, 2 September 2008.

<sup>16</sup> However, labor costs on South African wine farms are still considerably lower than in some of the old world wine countries: €2 per hour in South Africa versus €9 in parts of Spain (Rioja), for instance.

<sup>17</sup> From 2010, IPW auditing will be made mandatory for all export certifications (*the drinks business* South African Report 2008).

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<sup>18</sup> Some of the standards that are increasingly applied in the industry are the following: (1) the ISO 9000 and ISO 14000 series of standards on quality management and environmental management, respectively; (2) Hazard Analysis and Critical Control Point (HACCP) systems, British Retailer Consortium (BRC) and ISO 22000 certifications for food safety/quality management; (3) the WIETA code of conduct, based on South African labor legislation; (4) Fair Trade certification, which aims at guaranteeing fair conditions in production and trade (see Kruger and du Toit 2007) and has been quite successful in terms of market expansion, especially in the UK through the Thandi brand; and (5) organic and biodynamic certifications.

<sup>19</sup> BWI has seven champions, eight cooperative cellar members, and 99 regular members (<http://www.bwi.co.za/members>, last accessed April 2008).

<sup>20</sup> For instance, at the Cape Wine 2008 exhibition, a group of local producers were very vocal in their criticism of WOSA's slogan, arguing that 'we don't sell flowers'.

<sup>21</sup> See du Toit, Kruger & Ponte (2008) for a discussion of Black Economic Empowerment in the wine industry.

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Table 1: Overview of product upgrading in the South African wine industry	
Product upgrading	
Aspect of upgrading	General trend in South African wine industry
unit price	increased only slightly
overall intrinsic quality	improved
red/white composition	more reds
proportion of exports over total production	increased
proportion of bottled exports vs. bulk exports	increased, but then stagnated in the 2000s
proportion of natural vs rebate/distilling wine production	more or less the same
noble variety proportion	increased
top quality wines	number and visibility increased
alcohol levels	increased
proportion of wine certified under Wine of Origin Scheme (generic indications)	increased
proportion of wines certified under Wine of Origin Scheme (specific indications)	no large increase given the growth of exports
product consistency	improved

Source: Interpretation of data presented in Ponte (2007a; 2007b); see also Tables 2, 3 and 4.

Table 2: Average prices of wine sold in bulk in South Africa							
ZAR CENT PER LITER							
Varietal	2000	2001	2002	2003	2004	2005	2006
All varieties	212.03	229.23	299.36	378.06	354.16	338.35	338.42
All red varieties	603.56	607.60	624.66	642.56	547.28	440.49	406.02
All white varieties	145.67	155.88	216.25	291.69	287.97	297.57	310.51
Concentrate / Sweet must for sweetening	138.90	144.69	164.77	212.13	233.07	240.21	236.99
Rebate wine*	119.56	115.20	130.23	186.57	198.21	206.79	210.09
Distilling wine*	64.86	63.16	73.50	103.09	94.65	97.43	92.78

Note: \* ZAR cent per liter 10% alcohol  
Source: elaboration on SAWIS (2007; Table 7.2)

Table 3: South African wine production, sales and exports

		1996	2004	2005	2006	2006
		tons	tons	tons	tons	% of total
<b>GRAPES CRUSHED</b>						
White varieties		986,795	861,339	728,666	808,225	62
Red varieties		118,433	367,058	367,845	404,758	31
Table grapes		42,917	83,787	75,121	88,596	7
Total		1,148,145	1,312,184	1,171,632	1,301,579	100
<b>PRODUCTION</b>						
		million litres	million litres	million litres	million litres	% of total
Wine		680	697	628	710	70
<i>White</i>			445	384	451	63
<i>Red</i>			252	244	259	36
Rebate wine		271	85	83	82	8
Distilling wine		(incl. in rebate)	146	129	148	15
Non-alcoholic		62	88	65	73	7
Total		1013	1016	905	1013	100
<b>DOMESTIC SALES (WINE)</b>						
		million litres	million litres	million litres	million litres	% of total
Natural wine *		360	309	301	301	82
Fortified wine		38	35	36	35	9
Sparkling wine		8	8	8	9	2
Brandy @ absolute alcohol		24	19	20	20	6
Total		430	370	365	365	100
<b>EXPORTS (WINE)</b>						
		million litres (1995)	million litres	million litres	million litres	% of total
Natural wine		71	266	280	269	99
<i>White</i>			127	130	116	43
<i>Red</i>			127	137	137	51
<i>Blanc de Noir / Rosé</i>			11	13	16	6
Fortified wine		1	0	0	0	
Sparkling wine		1	2	2	2	1
Total		73	268	282	272	100
Export sales over total volume of sales of natural wine (%)		17	46	48	47	
<b>STOCK (as on 31 December)</b>						
Total			million litres	million litres	million litres	
			364	339	403	

Note: \* includes wine used in grape-based liquor and alcoholic fruit beverages

Source: Elaboration from SAWIS (2007, Tables 2.1 and 2.2; and 1998, Table 1)

Table 4: Bottled and bulk wine exports per country (million litres, 2005)

COUNTRIES AND COUNTRY GROUPS	Total (bottled and bulk)					Bottled		Bulk		1995	
	WHITE	RED	BLANC DE NOIR / ROSÉ	TOTAL	% of total exports	Litres	% of bulk +bottled	Litres	% of bulk +bottled	Total bulk+ bottled (million litres)	% of total exports
United Kingdom	57,991	41,543	2,679	102,213	36.5	78,326	77	23,888	23	31,478	44
The Netherlands	16,435	24,494	5,997	46,926	16.8	28,673	61	18,252	39	6,127	9
Germany	10,200	23,278	2,421	35,899	12.8	15,728	44	20,170	56	5,704	8
Sweden	9,572	10,431	6	20,009	7.1	20,010	100	0	0	5,270	7
Canada	6,127	6,415	49	12,591	4.5	6,519	52	6,071	48	3,546	5
United States of America	4,232	5,651	131	10,014	3.6	10,014	100	0	0	1,263	2
Denmark	2,450	7,262	3	9,715	3.5	6,558	68	3,157	32	**	
Belgium	4,110	3,611	465	8,186	2.9	4,548	56	3,639	44	1,761	2
Australasia	5,622	180	30	5,832	2.1	309	5	5,524	95	439	1
Other	13,172	13,832	1,482	28,486	10.2	18,730	66	9,755	34	15,620	22
<b>TOTAL</b>	<b>129,911</b>	<b>136,697</b>	<b>13,263</b>	<b>279,871</b>	<b>100.0</b>	<b>189,415</b>	<b>68</b>	<b>90,456</b>	<b>32</b>	<b>71,208</b>	<b>100</b>
** incl. Denmark and Finland											

Source: elaboration from SAWIS (2006; Tables 8.3 to 8.5)

Table 5: Overview of process upgrading in the South African wine industry

<b>Process upgrading</b>	
<i>Aspect of upgrading</i>	<i>General trend in South African wine industry</i>
managerial systems	improved
viticultural practices	improved
winemaking practices	improved
labour	some upgrading of permanent workers' skills; increased proportion of casualized labour
food safety and quality management certifications (BRC, IFS, HACCP, ISO 9000)	becoming more common
environmental and social certifications	entering the industry, but not common yet (except for fair trade)
marketing, advertising, provision of promotional support	improving, but still a weak point
brand recognition	improving, but mainly due to Europe-based marketers
brand South Africa recognition	not strong enough, especially in the US
accessing higher-margin markets	some success in Sweden, limited but promising inroads in the US

Source: Interpretation of data presented in Ponte (2007a; 2007b)

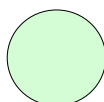
Table 6: Top 10 South African brands in the top-50 brands in the UK off-trade market (July 2005-July 2006)

<i>Brand name</i>	<i>Producer</i>	<i>Main brand owner/distributor</i>	<i>volume (thousand litres)</i>	<i>change over previous year (%)</i>	<i>UK ranking (2004)</i>	<i>% of total SA sales</i>
Kumala	Western Wines	Constellation (US)	19,620	-0.2	4	27
Own-label	various	Retailers' own label	12,600	-8		17
Namaqua	Westcorp/ Namaqua	Raisin Social (UK)	6,534	5.5	18	9
FirstCape	FirstCape and a coalition of cooperatives	BrandPhoenix (UK)	4,338	115		6
Arniston Bay	the company of wine people	Ehrmanns (UK)	3,825	-13	20	5
Stowells South African	various	Stowells (UK)	2,727	8.5		4
Evolution	Western Wines	Constellation (US)	2,385	-20.9		3
Dumisani	Winecorp	Winecorp (SA)	1,629	-11.7		2
Goiya	Westcorp/ Namaqua	Raisin Social (UK)	1,503	-44.7		2
Pearly Bay	KWV	Edward Cavendish & Son, wholly owned by KWV (SA); from 2007: Thierry's (UK)	1,476	37.4		2
Total bottled SA sales in UK			73,800,000	-9		

Source: ACNielsen and field interviews

Table 7: Overview of functional upgrading	
Functional upgrading	
<i>Location of upgrading</i>	<i>General trend</i>
in South Africa	cellars and producer-wholesalers are moving away from (or reducing involvement in) grape-growing
	producer-wholesalers moving away from (or reducing involvement in) winemaking
	some cooperatives and ex-cooperatives are more engaged (though joint ventures) in marketing and branding
	product innovation increasingly done by European/US marketers and agents
in Europe	South African producer-wholesalers and marketers divesting from own agencies in the UK and Europe
	South African producer-wholesalers and marketers entering in joint ventures with Europe based agents and marketers
	Exclusive brand ownership by South African actors decreasing
	European marketers and agents taking over more control of logistics and replenishment

Source: Interpretation of data presented in Ponte (2007a; 2007b)



Source: Modified from Ponte (2007b)