

Faults in Existing Industry Commercial Practices



Industry has acknowledged supply and demand imbalances since 2005-06 at least, as well as the need for action. Yet, in what is approaching a decade of realisation, the imbalances have failed to resolve.

It's crunch time for many growers.

Faulty commercial arrangements, stemming from uncritical acceptance of traditional practices, prevent the operation of all-important market signals that enable markets to work at clearing imbalances in supply and demand.

Major faults in accepted commercial arrangements span many facets of financial operations in winegrape growing businesses

1. The vineyard investment dynamic

- Significant establishment costs and lagged returns act as a barrier to exit during business cycle troughs.
- This factor stands in the way of generational change at the present time when the industry needs to rejuvenate its age demographic.

2. Traditional winegrape price determination practices do not send clear market signals

- Prices are frequently disclosed *after* a grower has made their investment and therefore their financial commitment to a crop. This includes vineyard management decisions made in response to guidance from wine companies to achieve wine company goals, that are made at cost to the grower.
- Prices are frequently not transparent.
- Prices generally confuse economic determinants of price (supply and demand) with quality determinants by not discriminating between the two.
- Low prices determined purely on supply and demand characteristics may act perversely to the desired quality goals of wine companies through increased vineyard yields that are boosted to maintain profitability on a per hectare basis.
- Despite an abundance of Australian-developed measurements of quality indicators, price determinations based on quality assessments typically lack accountability due to the scarcity or even absence of objective measures that justify price outcomes.
- Prices may be distorted by reference to science where the connection with quality is unsubstantiated.
- Alternatively, prices may allude to scientific objective measures despite there being none in the wine sector that are sanctioned in law as trade measures.
- Prices frequently provide little assurance to growers that their remuneration is fair and reasonable.
- Prices often represent the misuse of market power in the grower/wine company relationship.
- Price outcomes are hard for growers to dispute because of lack of transparency as well as the imbalance of market power between growers and wine companies.

- Prices are evidently used opportunistically by some wine companies to the disadvantage of growers and at the expense of meaningful and mutually rewarding long-term business relationships.

3. Traditional terms of trade for winegrape sales

- Traditional terms of trade typically allow wine companies to hedge their marketing risk by not committing to price signals until up to two weeks before harvest thereby pushing their market risk onto growers who have committed financially to a crop.
- Through three-part payment schedules, legislated in South Australia and adopted in the Wine Industry Code of Conduct, growers effectively act as lenders to wine companies who seek to maintain cash flows while wine matures for sale.
- Terms of trade frequently provide no security for growers' unpaid winegrape supply when a buyer's business fails.
- Terms of trade basics are observed to be imperfectly couched in industry contracting practice (reference: <http://wgga.com.au/archives/5792>).
- The basics of good commercial practice are not supported by the winemaking community as demonstrated by the failure of the larger numbers of winemakers to become signatories to the Wine Industry Code of Conduct.

4. Business decision-making by growers is constrained

- Information from government and industry service bodies is lacking due to contraction of resources.
- The industry's R&D function is reluctant to support foundation data sets.
- Grower business-skill levels are sub-optimal for modern, competitive growing businesses.
- Many traditional wine company contract and commercial practices do not establish clear market signals (for both supply or desired quality) that encourage supply to meet demand.
- The grower community generally lack skills to market their fruit.
- Many wine companies demonstrate a lack of willingness to partner with growers in value-chain relationships.

*Wine Grape Growers Australia
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