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Analysis of the South African wine industry: Lessons for LED practitioners



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Analysis of the South African Wine industry: Lessons for LED practitioners

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1. Introduction

The lack of creation of sustainable jobs in South Africa was raised again and again during the 2009 general election. For about two decades Local Economic Development (LED) has been seen as a panacea, but its results have been largely disappointing, especially in smaller rural municipalities¹. A recent review of LED policies and experiences recommended that the gap in LED practice between that in large cities and in small towns and poorer municipalities be closed¹.

LED officials are challenged to find innovative approaches, a few of which have been mentioned. The development of clusters of businesses is seen as a means of creating competitive rural industries. Clustering refers to groups of enterprises that produce the same type of products, often in competition with one another, but cooperating in other ways to achieve success for all.

Paradoxically, South Africa has an oft unrecognized but extremely important world-class low-tech rural cluster, namely the wine industry. This cluster has been so successful that it grew its exports in 2008² during the worst financial crisis the world has seen in decades. There are important LED lessons to be learnt from the successes of the wine cluster and related enterprises and the purpose of this document is to present these.

The wine cluster offers LED lessons for South Africa

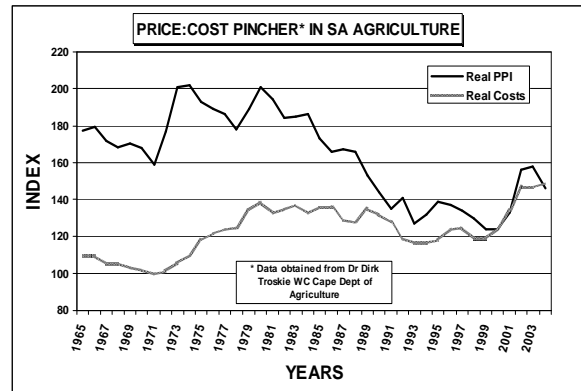
2. Methodology

South African agriculture is firstly broadly examined (exports are used as a measure of success) before the wine industry is analyzed to extract its key success factors. Additional examples are then presented in order to integrate the LED lessons for South Africa.

3. Realities of South African Agriculture

South African agriculture has been under severe price pressure for four decades or longer (Figure 1).

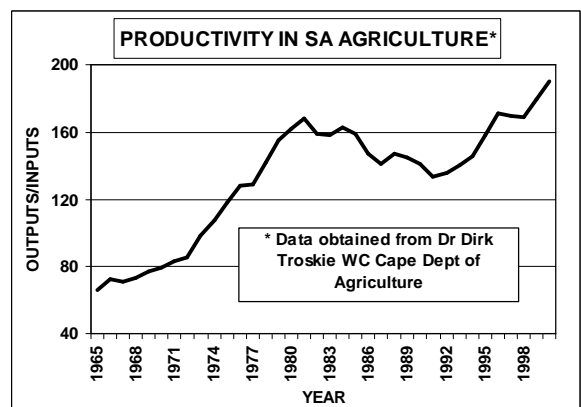
Figure 1: Price:cost pincher in SA agriculture



Margins were reduced systematically and economic survival was sought in increased productivity (Figure 2), achieved using increased mechanisation and automation, and the use of improved stock and plant varieties.

Figure 2: Productivity in SA agriculture

These strategies had important



consequences: (i) a reduction in the lowly-educated (mainly black) worker group and (ii) an increase in the more highly trained (mostly white) worker group (Figure 3) – the so-called “machines in, humans out” phenomenon. The knowledge workers were needed to tend the increasingly sophisticated equipment used.

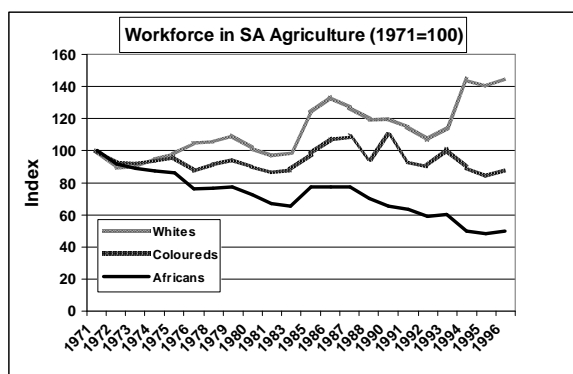


Figure 3: The SA agricultural workforce

Globalization added to these dynamics. Maize has traditionally been a major South African agricultural export commodity. Since 1975 the USA, Argentina and France have maintained their competitiveness in maize exports, South Africa has gone backwards and China and Brazil have become strong competitors (Table 1).

Table 1: FAO statistics of top 20 maize export countries*

	USA	SA	France	Argentina	China	Brazil
1975	1	4	3	2	13	7
1980	1	3	2	4	13	21
1985	1	8	2	3	4	21
1990	1	5	2	4	3	21
1995	1	4	2	3	20	21
2000	1	7	2	4	3	21
2001	1	8	2	3	4	5
2002	1	7	2	4	3	5
2003	1	8	3	4	2	5
2004	1	12	2	3	5	4

* 21 indicates a country is not under the 20 top exporters

Government subsidies by developed countries are often blamed for poor agricultural performance of developing countries. However, South Africa's poor performance in maize exports is also due to strong competition by other developing countries, e.g. Argentina, China and Brazil (Table 1).

Competing with commodities in global markets is difficult if you are not the cost leader

In contrast to maize, South Africa's competitiveness in wine exports has rocketed since 1990 (Table 2) and even the financial crisis since 2008 did not diminish its performance. It is now the number one agricultural South African export. Whilst we know why maize lost its premier position (lack of competitiveness) we have to ask why wine became the premier agricultural export. The basic answer lies in the different nature of wine, a differentiated product, compared to maize, a commodity product.

Table 2: FAO statistics of SA maize and wine exports*

	Maize	Wine
1975	1	21
1980	1	21
1985	6	21
1990	1	18
1995	2	1
2000	8	1
2001	6	2
2002	2	1
2003	7	1
2004	7	1

21 indicates a position outside the top 20 exports

This difference is vital in understanding and creating sustainable competitiveness in low-tech rural industries.

Distinguish between commodities and differentiated products

4. The competitive playing field

Many sport-loving South Africans will immediately recognise Figure 4 as the outline of a rugby field. They will intuitively understand that different strategies will apply to different parts of a rugby field. Toerien³ suggested that the 'competitive playing field' of enterprises is defined by two continuums: (i) the low-tech to high-tech continuum, and (ii) the commodity products/services to differentiated products/services continuum (Figure 5).

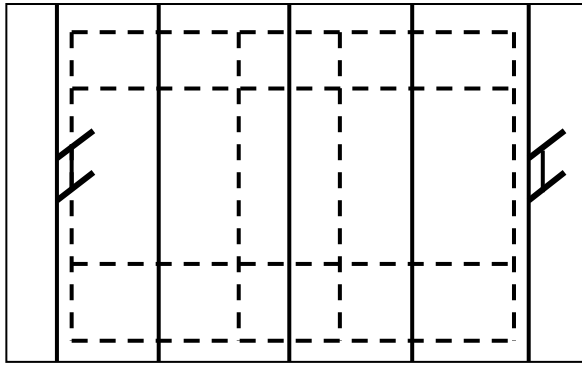


Figure 4: Rugby playing field

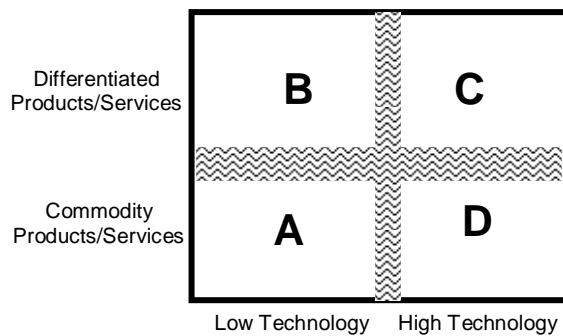


Figure 5: Competitive playing field of enterprises

Few people intuitively understand this playing field. Uniqueness determines sustainable competitiveness in differentiated products and services (quadrants B and C) whilst cost leadership determines competitiveness in commodity products and services (quadrants A and D). Because South Africa is no longer able to produce maize that is cost-competitive, it has lost its position as a top maize exporter in the world. On the other hand because South Africa and Australia are able to differentiate their wines from each other as well as other wine producers, they were able to increase their wine exports (Figure 6).

However, Australia's wine exports have been outstripping those of South Africa, indicating that they have increased their competitiveness even more rapidly than South Africa. This is also true for the United States and Chile. Why were they able to achieve this?

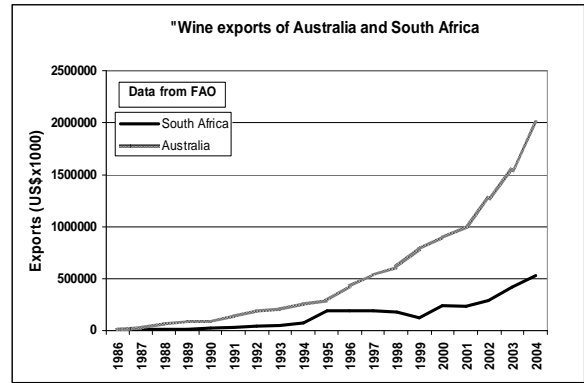


Figure 6: Wine exports of South Africa and Australia

Wines offer wonderful opportunities to differentiate products. A French wine can never be a South African wine, or vice versa. A wine of Van Loveren can never be a Constantia wine, or vice versa. If Indians and Chinese seriously start producing wines, they will not be able to produce a South African wine unless they start operating wineries in South Africa rather than in India or China. In addition, each year has different climatic conditions contributing to an 'in-built' differentiator in terms of year of production. The type of grape used, opportunities to blend different grape varieties and the use of the name of the wine maker on the label create further opportunities for differentiation of wines, contributing to sustainability. Some European wineries are older than a thousand years!

Uniqueness confers sustainable competitiveness in differentiated products and services

5. Primary drivers of low-tech competitiveness

There are three primary bases for sustainable low-tech competitiveness³: (i) talent (human excellence or the ability to do something a machine cannot yet do), (ii) know-how and/or (iii) attractions (natural or man-made).

Some examples serve to illustrate this. The creative talents of designers form the basis

of the fashion industry and those of authors and movie stars form the basis of the publishing and movie industries. The enormous modern sport industry with its numerous branches depends on the talents of athletes, male and female. Artists and sculptors, some from earlier centuries, provide the basis of numerous art museums all over the world.

Talents and know-how (secret knowledge) form the basis of the whisky, cognac and brandy industries. This is also true for most restaurants, especially top-class ones. The whole cosmetics industry depends on the know-how of formulators. Warren Buffett became the richest man in the world because of his know-how of making investments.

Man-made and/or natural attractions form the basis of the enormous tourism industry. Jerusalem has been a tourist destination for more than a thousand years, London and Paris for hundreds of years and the Kruger National Park for more than 100 years. The vastness of deserts, the isolation of Antarctica, the white waters of fast-flowing rivers and the peaks of the highest mountains attract adrenalin junkies. Tourists flock to see whales, the 'big five' or special birds.

Combinations of talent, know-how and attractions can create wonderful business opportunities, e.g. the creative genius of Andrew Lloyd-Webber, the attractions of London and New York as world cities and excellent theatre infrastructures gave rise to money-spinning musicals such as Phantom of the Opera or Cats.

Talent (human excellence or the ability to do something a machine cannot yet do), know-how and/or attractions (natural or man-made) form the basis of sustainable low-tech businesses.

We can now return to the question about the competitiveness of the South African wine industry. Wine has been made for thousands of years. The basic process, fermentation of sugar in grapes to alcohol, has not changed over time. Better technology has improved the processes of wine making, bottling, aging and distribution of wines but the quality of wines is still primarily dependent on the talents and know-how of viticulturists and wine makers. The wine industry, like many other successful low-tech industries, is part and parcel of the Creative Economy.

The Creative Economy, dependent on human talents and know-how, is important for rural LED strategies.

6. Other Key Success Factors (KSFs)

The primary drivers (talent, know-how and attractions) are not sufficient by themselves to guarantee world-class low-tech enterprises. A number of additional KSFs have to be managed exceptionally well³.

6.1 Building brands

All world-class low-tech enterprises are exceptionally good at building their brands. Trademarks and logos are assiduously protected. The prime example is Coca-Cola, a soft-drink manufacturer whose brand in 2008 was worth in the order of \$65 billion.

One of the most important ways of differentiating wines from one another is through the names used for wineries. Most South African wineries are mindful of their names and protect these legally.

World-class low-tech enterprises are exceptionally good at building their brands.

6.2 *Quality*

Quality has become a ‘poker chip’ in the business world, if you don’t have it you do not play. It now rarely serves to differentiate one enterprise from another. South African wineries have high-quality products and if foreign wineries cannot match them they simply do not play. An important corollary is that because world-class wineries are increasingly exploiting business opportunities in other parts of the world, all wineries have to become world-class simply to survive in their own markets.

The South African wine industry is very watchful of wine quality. For example, when illegal additives were identified in some South African wines remedial steps were immediately taken.

Formal and informal competitions such as the Veritas or Michelangelo Awards contribute to an awareness of wine quality as an important issue.

Quality products and/or services are non-negotiable. If you cannot match your competitors you simply do not play!

6.3 *Marketing*

World-class low-tech businesses have for more than a hundred years developed world-class marketing skills to offer their products to existing and new clients. For instance, Glenfiddich, the well-known Scottish whisky producer, produces all of its whisky in Dufftown in Scotland but markets it to niche markets in more than 200 countries. Glenfiddich had to develop an outstanding marketing division.

The South African wine industry has created Wines of South Africa (WOSA) to create international awareness of South African wines and plays a role in international marketing. Many wine cellars also market their wines directly overseas. Weblogs

(blogs) are also increasingly used to market South African wines overseas, e.g. Stormhoek wines.

World-class marketing abilities and infrastructure are needed

6.4 *Gaining market intelligence*

Gaining market intelligence, i.e. understanding what customers need and want is absolutely required in low-tech enterprises producing differentiated products or services. World-class low-tech businesses often utilise trade shows and the like as a means of gaining market intelligence.

Many South African wineries are active in local and international wine shows where they gain market intelligence. South Africa’s reputation as a producer of good quality wines has also been strengthened by a string of international awards won at such wine shows.

Trade shows are important to gain market intelligence.

6.5 *Innovation*

World-class low-tech enterprises are continuously broadening or changing their product or service ranges. Innovation and the application of creativity play an important role in innovation efforts.

The innovative efforts of the South African wine producers increased rapidly over the past decade. Greater exposure to international buyers, the efforts of WOSA and other bodies, research support by the Agricultural Research Council and cooperation between wine cellars, among others, have contributed to the innovation efforts.

Innovate or die!

6.6 Logistics

Successful world-class low-tech enterprises are exceedingly good at maintaining price premiums in their markets. These enterprises are able to match demand and supply in such a manner that oversupply does not lead to a reduction in prices. This requires world-class logistics management throughout the whole value chain of the enterprise.

South Africa is strategically well positioned relative to its major wine markets in European and increasingly in North American countries. As a consequence, South African wine producers do not have major transport problems in delivering their products to their markets.

Match demand and supply in such a manner that oversupply does not lead to a reduction of prices.

This short overview of the South African wine industry shows why it is so successful. In summary: The wine industry: (i) is founded on the creativity of viticulturists and wine makers, (ii) produces products for which there is a world-wide and growing demand, (iii) individual wineries have brands that distinguish them from one another and from those of other countries, (iv) manages product quality effectively, (v) has WOSA that creates awareness of South African wines and individual wineries markets widely, including internationally, (vi) systems have been developed to effectively handle the logistics of getting wines to markets, wherever they are, (vii) national and international competitions and exposure serve to provide market intelligence and (viii) the innovation efforts of individual wineries is complemented by the activities of government-supported research organisations such as the Agricultural Research Council.

In contrast, the South African maize industry does not comply with these

requirements. It delivers a commodity product that is neither based on human talent nor know-how nor attractions. Maize producers do not need to be branded because their product ends up in silos together with those of a multitude of other producers. They do not have to attend trade shows to gain market intelligence nor do they have to develop world-class marketing skills or logistics systems. Their innovation efforts focus largely on how to produce maize more efficiently than on how to produce better maize. They depend on Monsanto and other seed producers to do maize research.

To show that the wine industry is not alone in South Africa three additional short case studies of successful low-tech South African enterprises are presented. These are by no means the only ones in the country.

7. Ardmore Studio⁴

The owner of Ardmore Studio, Fée Halstedt-Berning, a ceramic artist trained at the University of Natal in Pietermaritzburg where an American, David Middlebrook shaped a lot of her thinking. Married in 1985 she moved to a farm in the Natal Midlands. There she started Ardmore Studio and employed Bonnie Ntshalintshali, a young woman with little schooling and who had polio as a child. The process to become a sustainable commercial operation and the production of unique ceramic art took a while. They initially painted eggcups and coffee mugs to earn the money to buy clay and paint. In 1990 Fée and Bonnie won the Standard Bank Young Artist Award and this set them well on the road to success. The production of functional ceramic art became the mainstay of their operation. In time a large group of local people joined them, were trained and became artists in their own right⁴. World-class creative capabilities resided in the peasant population of the Natal Midlands and the Ardmore Studio became the means whereby this could be unlocked.

A lot of things had to be learnt, e.g (i) operating a studio in a rural setting, (ii) simultaneously handling the roles of artist, teacher, mentor and businesswoman, and (iii) learning to market products in ways that avoided being dependent on flea markets and country fairs. Fée used friends and family in Johannesburg to develop a network of aficionados. Today Christie's of London auctions Ardmore's products.

Ardmore is: (i) founded on creativity, (ii) produces products for which there is a growing demand, (iii) has built a strong brand and manages its protection assiduously, (iv) manages product quality tightly, (v) has developed an effective marketing system, (vi) manages the logistics of materials and finished products effectively, and (vii) obtains market feedback that drives innovation.

Ardmore Studio unlocked world-class creative capabilities in peasants of the Natal Midlands

8. Kapula Candles

Ilse Appelgryn, a teacher at a high school in Bredasdorp, was made redundant by the Department of Education. She worried that she was not good enough and needed something else to do. She tried painting candles because an aunt of hers made candles and hand-painted them when she was a child. She had inherited the candle forms and started producing hand-painted candles. The local tourism trade snapped them up.

Soon she had several women producing and painting candles in her kitchen. In time she had to acquire another house in which to work. Today Kapula Candles has two factories in Bredasdorp, employs about 250 people and exports the major part of what they produce to discerning markets in Germany, France and other countries.

Kapula Candles produces a wide range of differently shaped and decorated candles, including some with distinctly African designs. The business: (i) is also founded on creativity (Ilse and her cousin are the designers of the patterns that are hand painted on to the candles), (ii) produces products for which there is a demand from housewives who want to create a specific ambiance through the use of candles, (iii) has built a strong brand and manages its protection, (iv) manages product quality tightly, (v) has developed marketing outlets in foreign markets and uses a major South African retailer for local sales, (vi) manages the logistics of materials and finished products using container-based transport, and (vii) has regularly attended international trade shows to obtain market intelligence that drives further product innovation.

Kapula Candles employs about 250 people and exports the major part of its products to discerning markets in Germany, France and other countries.

9. Carrol Boyes Functional Art (CBFA)

Carrol Boyes, with a degree in the Arts, was a teacher for 11 years. She resigned in 1989 to pursue her lifelong passion as an artist and designer. She began making verdigris candles, then switched to silver and made jewellery. In 1991 she combined her artistic flair and talent in sculpture with her jewellery experience to create distinctive and unique pewter handles for cutlery.

Today CBFA produces a variety of distinctive and uniquely South African functional art. Their designs are a marriage between western aesthetics and the diversity and rich culture of South Africa. All products are hand-made and are quite different from machine-manufactured products. No item is, therefore, exactly the

same as any other item and this is another facet of CBFA's differentiation.

CBFA manages quality carefully and their products will last a lifetime. These items are collectibles, not fashion items that are disposable.

CBFA's head office is situated in Cape Town where Carrol and her artistic team create prototypes for new designs. Actual manufacturing is done near Tzaneen in the Northern Province where the casting and stamping of the metals is done and larger items are assembled prior to transportation to Cape Town. Craftsmen polish all products in Cape Town where quality control is done before final dispatch.

CBFA produces products in pewter, spun aluminium, stainless steel and cast aluminium. They are continuously innovating to introduce exciting new products.

Many outlets sell their products in shopping malls all over South Africa. In addition, electronic marketing now attracts customers from all over the world. Carrol Boyes is now an icon recognized by leading national and international decor and lifestyle magazines.

CBFA also follows the business model for success in the low-technology differentiated products domain. The business: (i) is founded on creativity, in this case that of Carrol Boyes, (ii) produces functional art for which there is a demand from a wide range of people, ranging from house owners to business people, (iii) has built a strong brand and manages its protection carefully, (iv) manages product quality tightly, (v) has developed a wide range of sales outlets locally and also sells internationally, including growing its electronic sales, (vi) manages the logistics of materials and finished products carefully and uses containerised transport and courier services to transport products, (vii) travel internationally to gain market intelligence,

and (viii) continuously expands its product range.

The production of distinctive and unique functional art that is both useful and beautiful forms the basis of CBFA's success.

10. LED lessons summarised

There are two broad target groups for the lessons from the wine and other low-tech industries: (i) entrepreneurs and (ii) officials involved in LED.

10.1 Lessons for entrepreneurs

The first significant lesson from the wine industry for entrepreneurs is to believe that they can be as successful as many other South African wineries that have built extremely successful low-tech and sustainable businesses in South Africa. They should, therefore, pay careful attention to their choices of which businesses to pursue. If they want to build sustainable low-tech businesses with the potential to support their future generations they should: (i) look for business opportunities founded on products or processes based on (a) creativity and/or human talent, or (b) know-how, or (c) attractions, or (d) combinations thereof, (ii) consider lifestyle products, i.e. products that satisfy the higher needs of humans, (iii) build their brands over time and manage their protection carefully, (iv) manage product and/or service quality tightly, (v) build world-class marketing skills and use market intelligence effectively, (vi) manage their logistics of materials and finished products using their own or the transport systems of others, (vii) balance demand and supply and being careful to avoid imbalances leading to price reductions, (viii) use national and/or international trade shows to obtain market intelligence, and (viii) constantly innovate to improve or broaden their product or service offerings. The challenge is huge but numerous

entrepreneurs have met it successfully using this basic approach.

The challenge is huge but can be met

10.2 Lessons for LED officials

South Africa is in need of radically new approaches to LED. Officials are in the first line to handle this challenge. The lessons from the wine industry and elsewhere teach that sustainable success in low-tech ventures is within reach of entrepreneurs located in rural areas, and importantly, world-class creative abilities are often present there. However, the special entrepreneurship on which such enterprise development depends is limited and needs to be developed. In addition, LED officials have to undergo a paradigm shift. Instead of seeing such enterprises as ‘footloose’, and hence, outside planning perspectives, they have to accept that they can be included in strategic development planning. LED officials have to think differently, plan differently, train differently and implement differently. All of these are well within their capabilities but they have to be empowered to do it.

Think differently

South African LED authorities need to accept that neither commodity-based enterprises nor high-tech sectors will provide enough **sustainable** employment opportunities for the millions of poorly educated and trained unemployed South Africans. Hence, the importance of low-tech enterprises producing and/ or delivering differentiated products or services for sustainable job creation must be elevated to the strategic planning level. In order to do this, the lessons from the successes of the wine and other low-tech industries must be heeded.

Plan differently

Once the paradigm shift has been made, planning of development must include a

focus on the expansion of appropriate industries and enterprises. Chinese authorities planned for success in production of commodities⁵. South African LED officials should pay much more attention to exploit the low-tech differentiated products and services domain in an integrated fashion. Too many entrepreneurial opportunities are missed in this domain.

Train differently

Research has shown that value addition to primary products varies considerably in South African towns. Entrepreneurship and LED training presently lacks a focus on the factors important in the creation of **world-class low-tech enterprises** producing or delivering differentiated products and services. Such training should focus on the roles of talent, know-how, attractions, branding, quality management, marketing and market intelligence, as well as innovation management in building sustainable businesses. Entrepreneurs and LED officials should be trained in these aspects and suitable training programmes be implemented.

Implement differently

The LED strategy outlined here implies that South African LED officials should play a stronger direction-setting role, e.g. identify where the development of single or clusters of low-tech enterprises producing world-class differentiated products is possible. In this process cooperation with national and provincial authorities as well as entrepreneurs should be pursued. LED officials should, therefore, fulfil significantly different roles to the ones handled historically. They must be able to guide entrepreneurs in the selection of applicable business opportunities and understand the importance of a holistic mix of strategic planning and appropriate training. The LED officials will have to assist entrepreneurs to: (i) strategically select appropriate low-tech business opportunities, (ii) know how to build brands and manage intellectual property (e.g.

trademarks and logos) and be able to guide entrepreneurs, (iii) know how to manage product and service quality and be able to guide entrepreneurs, (iv) know how to gain market intelligence (including the use of the internet, attending of trade shows, etc.), (v) know how to build world-class marketing systems and be able to guide entrepreneurs, (vi) know how to build world-class logistics systems and be able to guide entrepreneurs, and (vii) know how to manage innovation for product and service expansion/renewal and be able to guide entrepreneurs.

These are huge but achievable challenges. The potential rewards for South Africa and its entrepreneurs make it worthwhile to pursue them.

**Think differently, plan differently,
train differently and implement
differently**

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