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“An Exploration of Strategic Issues Impacting Wine Co-operatives in the European Wine Industry”

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ABSTRACT
This paper analyses the main differences and convergence between the governance systems and organization structures in wine co-operatives from Italy, Portugal, France, and Spain. Our methodology combines the administration of an international survey with secondary data on the governance systems and organization structures of the Southern European wine co-operatives. Results demonstrate the dominance of two main governance systems (full vs. partial vertical integration). Furthermore, we find a significant increase of functional convergence however formal convergence is not significant. Therefore, further research on the institutions promoting functional convergence between wine co-operatives in different countries will help us to understand better the drivers impacting their competitiveness.

RESUMEN
Este trabajo analiza las principales diferencias entre los sistemas de gobierno corporativo y las estructuras organizacionales de las bodegas cooperativas de vino en Italia, Portugal, Francia y España. La metodología utilizada se fundamenta en una encuesta internacional, complementada con datos de fuentes secundarias sobre los sistemas de gobierno corporativo y las estructuras organizacionales de las bodegas cooperativas de vino en los países de Europa del sur. Los resultados demuestran la existencia de dos sistemas de gobierno principal (integración vertical completa vs. integración parcial). La evidencia demuestra un aumento de la convergencia funcional y que la convergencia formal no es significativa. En conclusión, los resultados sugieren la necesidad de promover la convergencia funcional entre bodegas cooperativas de los distintos países como una forma más fácil para entender los factores que impactan en la competitividad.

Palabras clave: gobierno corporativo, estructura organizacional, cooperativas vinícolas, competitividad, industria vinícola europea.

Introduction

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Co-operatives are non-profit organizations and therefore are a branch of the social economy. Wine co-operatives as a focal point is a research field that has not attracted an important flow of research and, with few exceptions, studies concern only a specific country or region (cf. Coelho et al., 2009, Bianchini et al., 2008). This work makes a contribution to broadening the knowledge of the field of wine co-operatives through the study of the logics structuring the strategic behavior of these organizations.

Co-operatives dominate the wine production in Southern European countries (i.e. France, Portugal, Spain, and Italy) and also have a strong presence in the New World producing countries. However, the structure and internal organization (e.g. the relationship between boards of directors and co-operative members, the relationship between employees and members) of these organizations remain relatively unknown.

Co-operatives are a multidimensional and complex subject as they are simultaneously embedded in a range of economic, financial, social, technological, political, and religious issues (Saïsset et al., 2011, Touzard et al., 2008). The goal of this study is to describe and explain the diversity of governance structures and performance of Southern European wine co-operatives. Therefore, we focus our analysis on two levels of strategies, i.e. the ‘business strategies’ (diversification and specialization), the degree of vertical integration of the wine co-operatives, and the performances of these co-operatives.

This research is structured as follows. First, we will discuss the main business strategies of wine co-operatives (specialization, diversification). After, we discuss the importance and the extent of vertical integration structures in these countries. Third, we will discuss the conditions of convergence (form, organizational) of the co-operatives in Southern European countries and the sustainability/persistence of wine co-operatives in the wine sector.

**Alternative models of business strategies**

In the wine regions where the co-operative movement has a strong presence it is possible to differentiate the strategies of wine co-operatives according to the strategic choices characterizing their business activities. The ‘business strategies’ here defined include the choices in terms of a pool of products, technologies, and markets. As a result of the growing internationalization of markets, the changing of winemaking production rules and the marketing of wine, the business strategies of co-operatives are therefore frequently changed and co-operatives must necessarily adapt.

Focus is a means used to manage the ‘dependency’ from stakeholders in the wine industry, i.e., a means to manage the bargaining power and improving competitiveness.

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2 This work was based on a phone survey with the representatives of wine co-operatives in France, Italy, Portugal, and Spain (2007-2009). The survey was completed with face to face interviews with co-operative members in those countries.
‘Specialization’ allow firms to establish competitive advantages: reaching the right size in terms of production levels, technology constraints/resources, and economics of scale, variety, and experience. A typical example is the case of co-operatives producing high volumes of bulk wines tailor-made for customers. This last example illustrates a case of strategies of specialization as a means to reduce dependency from stakeholders (customers, suppliers). Likewise, the strategy of specialization ensures a better effectiveness (i.e. quicker response to produce private labels, increasing focus on wine merchants’ claims...).

The wine sector offers a wide range of opportunities to specialize. The specialization can also be a means to avoid direct confrontation against big wine merchants. The positioning of wine co-operatives in the market ‘gaps’ (niches) would be one the best means to not attract attention of the majors in the industry. Some wine co-operatives in the New World have adopted this approach (South Africa, Chile, and Argentina) through a specialization on fair trade wines or in specific nods of the wine chain (grape growing, bottling, packaging, storage, marketing...). In this particular case, the competitiveness is based on cost-advantages corresponding to the search of niches strategically tenable. In this respect, the specialization involves some constraints. At first, by adopting this type of strategy it seems difficult to reach an ambitious goal leading to a faster growth. A strategy of specialization facilitates the emerging of new vulnerability factors (e.g. reduction of the customer base).

A ‘diversification’ strategy leads wine co-operatives to extend their business landscape and entering into new activities. Extreme diversification may lead firms to get involved in new businesses. However, this type of strategy requires caution because companies in the wine industry today tend to increase their ‘focus’ on the core businesses. Additionally, diversification raises problems in terms of the core competencies and the organization required by new businesses. Both, horizontal diversification (wine tourism, consulting…) and vertical diversification (forward and backward integration of businesses such as bottling, the sale of phytosanitary products...), are common strategies in co-operatives in Europe and in New World producing countries.

Generally speaking, the survey shows a dominance of the strategies of specialization across the world, particularly in Southern European countries. In Europe, strategies of diversification are dominant in Portugal. To some extent, this is related with the geography of the vineyards: small properties, family ownership, islands... explain the choices operated through these co-operatives. In Spain and Italy the diversification of activities is not so important (olive oil, grains...).

The complexity of the businesses related to wine production and the small size of the co-operatives may explain the dominance of the strategies of specialisation. Excepting Italy, where three major groups of wine co-operatives (Gruppo Italiano Vino, Caviro, Cavit), in the other Southern European countries the wine co-operatives are small in size and highly dependent on their domestic markets

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3 These co-operatives can be named as being “hectomaniacs”, i.e. co-operatives producing bulk wine, outsourcing, private labels (Courderc and Remaud, 2004).
direct exports is the main strategy to penetrate foreign markets). However, in some Southern European regions, co-operatives remain the leading wine producers.

Finally, in every country, the business strategies of wine co-operatives remain relatively stable across the time (i.e. diversification or specialization). This view is consistent with the long-term significance of wine co-operatives in these countries.

**A first typology of vertical integration models in wine co-operatives**

The specialization of the production basins where bulk wines dominate can be explained through social, history, and agronomy. Afterwards we introduce two dominant models in wine co-operatives, i.e., the model described as “collection-vinification-bulk” (partial vertical integration) and the model of “collection-vinification-bottling-sales” (complete vertical integration). These two models can be found in most of the international grape growing basins.

From a conceptual perspective, the transaction costs approach (Coase, 1937, Williamson, 1986) explains the reasons for the choice between partial and complete vertical integration. Partial vertical integration (collection-winemaking-bulk) is adopted when wine co-operatives lack of specific competencies particularly in terms of marketing and sales. The complete vertical integration is recommended when wine co-operative evidence some ineffectiveness when compared to the market. The choice of the degree of integration is determined by the characteristics of the transactions (i.e. the frequency, uncertainty, and the specificity of the assets).

The internalization of transactions reduces particularly the costs related to the access to information and the bargaining costs. When the economies of transaction costs are reduced or when the transactions are expensive to make internally (e.g. bottling, packaging, storage, sales, marketing), wine co-operatives choose to not fully integrated the different activities in the wine chain. Vertical integration engenders distortions and specific and irreversible costs (i.e. sunk costs) (Coase, 1937).

**The organizational model of « collection-winemaking-bulk »**

In this model, vertical integration downstream is partial because co-operatives do not full integrate downstream activities (bottling, packaging, sales, marketing) (Couderc and Remaud, 2004).

The wine price becomes the main adjustment variable in the decision-making process because there are very few factors to differentiate the wines. In a context of growing internationalization of the bulk wine markets where co-operatives are essentially price-takers this co-operative model faces a large number of risks. Saisset et al. (2011) document that growers’ remuneration in the South of France is related to the price levels obtained for the sales of the bulk wines. Also, market competition is influenced not only by wine merchants that purchase bulk wines but also middlemen (wine brokers…) that source their wines in a small or international scale, increasing competition across the wine chain.
Partial vertical integration (i.e. collection-winemaking-bulk) characterizes the regions where co-operatives dominate wine production. This is the typical model characterizing the Languedoc-Roussillon, South Italy (Puglia, Sicily) and Castilla-La-Mancha (see for example. Couderc, 2004, Torcivia, 2009). Even if in these regions the supply of wine in bulk through wine co-operatives accounts for approximately 75% of the volumes in each one of these regions the business models operating in these regions are quite different. Languedoc-Region is characterized by ‘qualitative’ reconversion and the building of a mass-market of international varietals such as Cabernet Sauvignon, Merlot, Syrah, Chardonnay and Sauvignon Blanc. In Sicily, the supply is highly-dominated by autochthonous varietals such as Catarrato and Nero d’Avola. According to the industry members, in Castilla-La-Mancha co-operative members do not define themselves as wine producers, their business consists of ‘growing grapes and not making wine’. To some extent, this model is explained by the European wine policy, the Common Market Organisation (CMO) for wine established in 1999, where co-operative members adopted a business model focused on the production of grape for distilling potable alcohol partly subsidized by the EU. The new CMO for wine adopted in 2008 transformed the strategies of the co-operatives in Castilla-La Mancha (i.e. suppression of the financial subsidies for distilling wine within the EU-27), fostering mergers, acquisitions, and partnerships between co-operatives across the supply chain.

The increasing concentration of buyers (wine merchants, wholesalers, retailers…) puts pressure on the head of the wine oligopoly, Therefore, the dependency from downstream stakeholders in the wine chain (wine merchants and brokers) is a key variable in the adjustment of the supply of bulk wines.

Since the 1960s, the ‘qualitative’ reconversion of vineyards in Languedoc-Roussillon, improved the quality of wine (i.e. international grape varieties) in this region and led to a change from a ‘mass’ (volume) market to a more quality-driven viticulture. The main goals during this period consisted on the adaptation of the demand to the international markets and to provide a reaction to New World competition. The establishment of “partnerships” or “contracts” with wine merchants: stability of the downstream relationships and taken into the account the medium and long-term (strategic investments became an opportunity). In France, wine co-operatives are essentially concentrated in the South of France (Rhone valley, Languedoc-Roussillon, South-West, Provence…). All things considered, net profits in co-operatives are on average approximately 1% and this is a major constraint to self-financing the co-operatives’ projects (Couderc, 2008).

The Portuguese model is dual. In Southern Portugal (Alentejo) wine co-operatives are the leading organizations, adopting a vertically integrated model (there is no bulk wine market). In other Portuguese regions the partial vertical integration dominates (i.e. there is an important market for bulk wines). Contrary to wine co-operatives in Alentejo, many wine co-operatives merged their structures in other wine regions.

The organizational model of « collection-winemaking-bottling-sales »
Complete vertical integration (collection-winemaking-bottling-sales) of wine co-operatives was typically adopted by New World wine producing countries but the model is also established in the main European countries. This model is typical of the Southern European regions where the average prices paid for wine are higher (Bordeaux, Burgundy, Champagne, Rioja, Ribera del Duero, Tuscany, Piémont, Alentejo, Vinhos Verdes, Douro Valley). However, these production basins are also impacted by and increasing trend to merge wine co-operatives (see for example, Chevet, 2006 and Bélis-Bergouignan, 2008). Small wine co-operatives adopting a model of vertically integration specialize on niche markets. The major wine co-operatives in this model specialize in supplying specialties (e.g. PDO or G.I. wines, DOCG, sparkling wines…) or in alternative develop very well known brands (Couderc and Remaud, 2004). Contrary to the bulk specialists, co-operatives are required to invest in terms of marketing and sales forces.

Across Southern Europe in many production basins, the activities of bottling and sales are undertaken through groups of co-operatives (i.e. 2nd or 3rd level co-operatives). This is one of the main economic justifications advanced to establish structures of bigger groups of co-operatives. In short, both models of vertical integral (partial or complete) can be found in Southern European countries showing both advantages and disadvantages.

Both models of vertical integration make use of ‘inter-cooperation’, one of the main co-operative principles, particularly for sharing services in Southern Europe. In France, the Institut Coopératif du Vin (ICV) is a co-operative structure providing services for co-operatives involved in grape growing and winemaking. The services include all the activities related to grape growing, enology, training, and sustainable development. Also, another type of co-operatives providing services to the industry are the co-operatives specialized on providing technical services or machines for grape growing and harvesting (CUMA). These organizations make a major contribution to the mechanization of vineyards (harvesting machines). Some other co-operatives specialized on distilling wines as a means to regulate the wine lakes in Southern Europe (Spain, France, and Italy) and have an important role in the regions where co-operatives are the leading organizations. Nowadays, distilling co-operatives are increasingly involved in environmental and energy production issues.

**Convergence of form or function?** What exactly is converging in wine co-operatives

Ronald Gilson (1996) distinguished ‘formal convergence’ and ‘functional convergence’. At the European level wine co-operatives are embedded in different legal systems and factor markets however co-operatives share the same common rules within the European Common Market Organization (CMO) for wine. Functional convergence may differ because wine co-operatives may internalize governance systems differently. Also, incentive patterns are different among co-operatives (e.g. the remuneration to produce some varietals or the grading system using to pay for grape quality).
Our survey facilitated the identification of two main ‘political’ models involving wine co-operatives, established according to the geography of regions (see Touzard et al., 2008). In parts I and II we demonstrated the heterogeneity of these models through the analysis of the dominant models at work in Southern Europe, either through the main business strategies or the models of vertical integration. In this section, we will discuss the conditions of convergence of the wine co-operative models.

The convergence debate

Two streams of literature have preceded the current debate on the convergence of wine co-operatives. One stream of research focuses on the description of the national or regional patterns of wine co-operatives (see for example, Touzard et al., 2008). In particular, the Southern European model, the Eastern European model (former Communist countries), and the ‘New World’ (Argentina, South Africa…) models were depicted. Another stream of the literature is focused on studying the efficiency of wine co-operatives in different countries (see for example Bianchini et al., 2008). The analysis of the pros and cons of each system was at the core of the debate on convergence (Gordon and Roe, 2004).

The debate on convergence of the different strategic models involving wine co-operatives includes two types of research streams (see Touzard for South Africa and Languedoc Roussillon, Couderc et al., 2008 for a discussion on wine co-operatives in France and Italy, Coelho and Rastoin (2008) for a comparison of Southern European countries (Coelho et al., 2009, Touzard et al., 2009, Bianchini et al., 2008) for the importance of wine co-operatives in different countries and the major «political» models involving wine co-operatives, 2008).

These international studies recognize the importance of the national systems of wine co-operatives through a large group of variables or dimensions, such as the economic importance of co-operatives in a national setting, the application of the co-operative principles established by the International Co-operative Alliance (ICA) or the working agenda of wine co-operatives (see Touzard et al., 2008). However, it also recognizes the existence of some particular issues (e.g. renewing and motivating members, the application of the voting rules of ‘one person, one voice’). Accordingly, this research ranked the national systems of wine co-operatives in six different groups: vineyards in Northern Europe (Germany, Switzerland, Austria…), and the vineyards in Southern Europe, the vineyards in South Africa, the vineyards of New Member States of the EU-27 and other Eastern European countries (Bulgaria, Slovenia, Hungary, Croatia…), the vineyards from the New World producing countries and the other vineyards (see Touzard et al., 2008, p. 338-340).

In Southern Europe, wine co-operatives account for more than 50% of overall production of every country (France, Italy, Spain, and Portugal). However, in some New World countries, such as Australia, Chile or the United States, the wine co-operatives do not account for a significant share of the overall production (less than 1 percent of the country’s wine production). International differences
between wine co-operatives define a diversity of ‘political’ systems but co-operatives also share several elements within every country.

The progressive liberalization of international trade for wine (imports and exports) and the growing internationalization of wine co-operatives created new competitive conditions that fostered the convergence of formal (i.e. changes in internal regulations and national or regional laws on co-operatives) and functional institutions. However, the national systems of wine co-operatives adapted their functions but the forms remained.

Another stream of the literature focuses on the socio-institutional environment and on the stakeholders and issues operating in Southern European countries. The convergence of the practices in the field of grape growing (trellising, irrigation…), oenology (use of oak chips, wine blends …) and on terroirs (emerging of designations of origin in the New World…), or the politics for the regulation of vineyards (liberalization of vine plantings, subsidies granted by States and regions…) provide indications about the convergence in the long-run of the economics of wine in both Southern European countries and the New World regions.

**On the convergence of wine co-operatives: The necessary and sufficient conditions**

If there is a necessary condition for the convergence it is the fact that the expected benefits from a system should overtake the costs related with the transition process towards the new system.

We do not notice a case for formal convergence. Every system because every governance system is run by institutions and it has the necessary flexibility to find solutions within the borders defined by path dependencies (Gilson, 2004).

There is convergence of functions whenever the governance of institutions is enough flexible to meet the demands induced by the circumstances without any changes of the “formal characteristics of the institutions” (Coffee, 2000). The ‘reality’ of the wine co-operatives is therefore an ‘hybrid’ situation combining though elements of both formal and functional convergence.

Wine co-operatives are characterized by a system of functional convergence but not formal convergence

Some intermediaries maintain their influence over the conditions explaining the working life of the co-operatives, and particularly influence significantly the performance of these organizations (wine merchants, wine shops…). The influence of the intermediaries (both upstream and downstream of the wine chain) operates through cost structures and organization of wine co-operatives.

Wine co-operatives in Southern Europe do not register formal convergence because the institutions of every governance system have the necessary flexibility to find alternate solutions within the limits of the path dependency. Functional convergence operates at a broader level.
The convergence operates within the EU-27 through the adoption of a common framework (CMO) for wine involving a new recognition of enology practices, the liberalization of planting rights, the grubbing up of vines, a new segmentation structure for the European wines, and incentives to promote wines in non-EU countries (cf. Montaigne and Coelho, 2006, European Commission, 2008).

Additionally, the following issues illustrate the interaction between governance and formal and functional convergence. One of the issues concern the increasing changes in the taxation of vine and wine co-operatives. Vine and wine co-operatives may now establish subsidiaries ruled through the common law. Vine and wine co-operatives are allowed to publicly list in the stock exchange through initial public offerings however there are no significant cases of IPOs among wine co-operatives. Changes in internal contracts (internal rules, the harvesting regulations) and agreements (establishment of partnerships with wine merchants…)

Reaching this point we may now ask what are the normative and prescriptive outcomes. To a large extent, the creation and the expansion of wine co-operatives in Southern European basins are determined by the institutional setting. A multi-level analysis (macro. meso, micro) would help to identify the adoption of ‘old’ and ‘new’ managerial practices. Also, it would be helpful to analyze more deeply the main ‘political’ models at the country-level and to appraise its heterogeneity.

**Conclusion**

Is there an optimal model of wine co-operatives? Are national systems of wine co-operatives effectively converging towards a particular model? This paper contributes to this literature by investigating whether wine co-operatives located in Southern European countries converge to an unique model.

The comparison of the different Southern European governance systems and business strategies of wine co-operatives raises a challenging number of difficulties. In particular, a ‘national’ system may seem stable as a result of approaching stability on the formal differences across time. However, even if one of the countries reaches formal stability, several functional changes operate. For example, co-operatives specializing on bulk wines undertook a lot of new mergers in the period 2007-2010.

We notice a continuous trend to improve the convergence of the socio-institutional environment. Likewise, we notice an increasing change on the rules of governance (establishment of new subsidiaries under the law for general (‘limited’) companies, new initial public offerings undertaken by major groups of wine co-operative, introduction of professional managers to administrate the wine co-operatives and, to a less extent, the consideration of variable voting rights).

We have identified a great number of barriers to the convergence of wine co-operatives. Co-operatives are grapegrowers-owned organizations. Voice is based on the principle of ‘one person, one vote’. Very often, grapegrowers block strategic decisions decided by the grapegrowers. The same principles apply to the grapegrowers owning the biggest vineyard areas. Wine co-operatives are embedded on a diversity of institutional, legal, and even cultural settings acting as barriers to mergers. The regulatory
wine framework is based on EU directives but final decisions are rooted on every country legal doctrines (subsidiarization).

In summary, in this work we acknowledge that there are different patterns of wine co-operatives operating in Southern Europe. However, beyond the business strategies (specialization or diversification) and the vertical integration models, new research about wine co-operatives is required to provide a better understanding of the functional changes operating within the different regions in Southern Europe and therefore explaining the determinants of competitiveness of wine co-operatives.

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