

The dynamics of the Chinese wine-buying market

Andrew Thomson and Jeanine Marshall

EXCELLENT CHAOS

*'Everything under heaven is in chaos.
The situation is excellent.'*

This quote, attributed to Mao Zedong, could well be used to describe the Chinese wine market at present.

A CHANGING MARKET

From 1 January 2004 Chinese import tariffs on wine fell from 44.5% to 14%. This dramatic reform, brought on as part of China's accession to the World Trade Organisation (WTO), has caused substantial changes to pricing structures and branding within China's domestic market for wine.

One newspaper commentary¹ points out that foreign wines still hold a naturally advantageous position at the top end of the market. However, domestic wine producers who stick to their guns and pay more attention to the wine consumer will emerge as the big winners after the market settles down from its current period of confusion. Much seems to rest on the so-called 'wine culture battle' now under way in the Chinese market.

OPPORTUNITIES FOR AUSTRALIA

Because of the unsettled situation there is strong interest from China's wine producers and research institutes in cooperative joint ventures with Australian wine producers. According to a survey of wine companies and wine research leaders in China conducted by Minter Ellison, the 'New World' image of Australian wine is a strongly positive factor. To China's wine industry, Australian technology and partnership is attractive.

MARKET OVERVIEW

Statistics tell a story of rapid growth in both wine production and consumption in China. According to the China Alcoholic Drinks Industry Association, wine production in 2004 grew to 370,000 tons, an annual growth rate of 14.8%, while the value of wine sales domestically rose by 17.1% to 7.4 billion yuan (A\$1.15 billion). This is still very small compared with production of other alcoholic beverages, according to the China Economic Daily newspaper, which reported annual production figures for beer at 24 million tonnes, distilled spirit at 5.5 million tons, and rice wine at 1.5 million tonnes.

There are more than 300 wineries in China. Half the total acreage of grapevines is located in Shandong Province, a

Alcohol Production (2004)	Production (tons)
Beer	24 Million
Distilled Spirits	5.5 Million
Rice Wine	1.5 Million
Wine	370,000

Fig 1: Alcohol production in China (2004)

further 20% in the west of China along the Silk Road, and the remainder in areas north of the Great Wall, Yunnan Province in the south-west, and around Anhui Province in central China.

At present the industry is dominated by the six largest producers who account for 54% of total production. The average capacity of Chinese wineries is 2000 tons, with 70% of wineries under 1000 tons, 20% between 1000-5000 tons, and 10% over 5000 tons. Four of the six largest producers, Changyu, Great Wall, Dynasty, and Dragon Seal, are all over 10,000 tons.

Market research reports indicate that wine consumption is highest in the 34-45 year-old demographic group and lowest in the over-55s group. The growing trend towards eating out and eating more Western-style food is propelling wine consumption, although levels of wine knowledge among consumers and sales staff remains a problem for the industry.

CLASSIFICATION SYSTEMS AND FOOD AND BEVERAGE HEALTH STANDARDS

Classifications and standards for wine have been the subject of vigorous debate for the past year. At a wine conference in August 2004 in Shandong, participants debated different wine classification systems. Some experts argued that the French AOC system based on geographical indications of a wine was incompatible with current winemaking practice in China. They proposed instead a system of quality classification similar to the German system, using three levels of grade: Special, Excellent and Table, roughly equivalent to AOC, VDP and VDT grades. At present the only standards in China, based on the National Standard of China for Wine (GB/T 15037-94), are Compliant and Non-compliant.

DISASTROUS TEST RESULTS

According to the Xinhua newsagency, in March 2005 the National Industry and Commerce Bureau announced the results of a quality-testing program for 10 food and beverage groups, including tests performed on 93 wine companies in 16

¹ Employment Times newspaper, 2 March 2005

² Great Wall and Dragon Seal of Hebei Province, Dynasty, and Huadong of Shandong Province, and Lou Lan of Xinjiang Province.

cities. The Bureau reported that among the 10 groups surveyed wine had the lowest compliance rate at only 66.3%.

In order to reduce production costs many companies deliberately reduced the content of grape juice in their wine, making wine that failed to reach the stipulated quality standard. Some companies merely use flavour essence, pure ethyl alcohol, sweetening agents and water to produce a beverage. In many wines tested the food additive content exceeded allowable levels or producers used banned additives such as soluble saccharin and chemical sweetening elements.

This appalling state of affairs has prompted a move among wine producers to revise the national standard for wine. According to the National Centre for Standardisation of Fermented Foods work on a revision of the standard began in 2002 under the supervision of the Alcoholic Beverages Subcommittee of the National Food Standardisation Technology Committee.

Various large wine producers and wine research institutes participated in the discussions and drafting, using a sample group of 30 domestic wines and 10 foreign wines from countries including France, Argentina, Chile, Italy, and Germany. Based on testing data and OIV (Organisation Internationale de la Vigne et du Vin) rules, a revised draft of the national standard was released for comment and later amended before being transmitted back to the National Committee for expert examination and approval. The report suggests the new standard will be officially promulgated at the end of 2005.



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LOCAL ESTATE-BRANDED WINES BECOME POPULAR

Despite opposition to geographical indications as a classification system, one commentary reports that local or estate brands have become a new trend for Chinese wine. To address this trend large numbers of estate wine enterprises are appearing, and existing wineries are starting to put out estate-branded wines. The commentary indicates that industry heavyweight Great Wall has already developed a series of estates and can be regarded as being in the vanguard of estate-branded wines. According to the commentary, in international practice the geographical indication of a wine can largely determine the quality of the wine, its price, flavour and style. The vintage of a wine is thus becoming less important in the Chinese market.

INTELLECTUAL PROPERTY DISPUTES

In China, disputes over intellectual property (IP) issues such as breach of trade mark or copyright normally involve an aggrieved foreign party, but in the wine industry such issues can arise between domestic players. Last month industry heavyweight COFCO, owner of the Great Wall wine brand, sued two smaller rivals when they marketed a wine called 'Jiaoyu Great Wall.' COFCO obtained an injunction from a court to stop sales of 'Jiaoyu Great Wall' pending an argument over the quantum of damages.

MARKETING TRENDS - WINE CLUBS AND THE CULTURAL ATTACK

Marketing themes for wine are changing. Recently Gujing Zhuangyuan began marketing a wine called 'Sleepless Night', attracting great attention at this year's Spring Commodity Expo. This product, in its naming, packaging and pricing, focuses on night life as a sales theme.

Another marketing strategy is evident in the Shangri La Group's joint venture with the renowned Taiyuan Wine Company to offer a collector's red wine, with an elaborately designed label, in Shangri La's 21 hotels in China. The ruby-red wine has a strong fruit flavour and a light, delicate palate. It received the Outstanding Prize at the 2003 Hong Kong International Wine Show.

One observer³ notes that domestic wine producers are starting to change their marketing strategies, pointing to Changyu Wines establishing the first estate wine club in China at Huanan (see below).

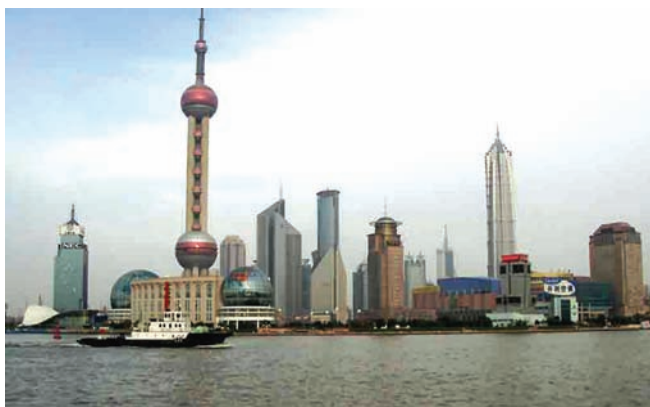
Behind these marketing trends is the so-called 'cultural attack' being mounted by foreign wine producers. In a recent interview a senior manager from Changyu commented on the tariff cut and the influx of foreign wines, remarking that these conditions are challenging prices and putting pressure on traditional domestic marketing strategies. One analyst agrees that the publicity campaign of foreign wine producers is forcing their domestic rivals to change tack from a pricing response to the most basic nurturing of consumers.

The *Nanfang Daily* reports that foreign wine is mainly marketed in China through wine import agents, such as ASC, Ming Te and Jun De. In contrast to domestic wine marketing, these import agents place more emphasis on final consumer

education, starting from the upper end consumer and trying to satisfy individualised consumer requirements in order to popularise wine culture.

Mr Li Hui of ASC's Guangzhou subsidiary notes that foreign wines can be marketed directly to the consumer after importation, but that China's wine market is still immature and current marketing strategies are only transitional steps. At present ASC imports 750 different wines from 12 countries. Its sales targets are mainly 4/5-star liquor shops, upmarket restaurants and high-grade department stores.

According to the newspaper *Beijing Modern Business*, the Changyu-Castel VIP Club, China's first estate wine club, has recently begun formally operating in Guangzhou. Industry insiders think this initiative will add substance to the current stage of conceptual development of Chinese wine culture and will move the sales/marketing mode of Chinese wine closer to international standards.



The vintage of a wine is becoming less important in the Chinese market.

It is thought that there is a strong cultural element to wine marketing in France, Italy and other premium wine-producing regions. Among the most direct strategies is to try by every possible means to shorten the distance between wine and its consumers, making wine buying a symbol of lifestyle, position and social status.

With the steep fall in import tariffs, industry observers forecast that prices of foreign wine will drop somewhat, and that as foreign wine's 'imported' culture gradually penetrates deeper into China, domestic wines will clearly come under unprecedented pressure.

THE BATTLE OVER WINE CULTURE

The example of Changyu shows that domestic brands are trying to blaze new trails in marketing to break out of their encirclement by the foreign brands. In 2003 Changyu aimed at the high end of the market by pioneering a marketing strategy that allows for ordering a whole barrel of wine. The volume of sales so far has reached 300 barrels. Now, with the establishment of the Changyu-Castel VIP club, they have a one-to-one connection with the consumer, using this to build a loyal group of customers.

Mr Li Li, general manager of the Changyu-Castel VIP

³ *Nanfang Daily newspaper*, 25 March 2005

club, explains that they now have over 200 members, including the celebrities Wu Zheng and Yang Lan. Future development plans of the club, with Guangzhou as the centre, are to recruit 500 new members in the Huanan region and to duplicate the Guangdong sales/marketing mode in Beijing and all other regions.

Li commented that 'the one-to-one experience sales/marketing strategy is the club's biggest special attribute'. At a club gathering a foreign sommelier, specially invited by Changyu, gave a presentation to around a hundred guests, affording them the benefit of an intimate experience of wine culture. As a service to members the club publishes *Wine Appreciation*, a magazine giving expert guidance on different aspects of wine.

Industry insiders anticipate that in the next two to three years foreign and domestic wines will clash in the battle for consumers. Whoever wins this battle will lead the development of the Chinese wine industry. Changyu has already started with a multi-billion yuan investment in a high-grade estate at Yantai and with its VIP club, and this year has aspirations to cater for foreign clients. All these sales/marketing strategies, however, centre on the battle over wine culture.

ORGANIC CERTIFICATION

As a result of the measures coming into force, China now has a standard symbol or mark for certified organic foods. Only foods that comply with the standards may carry the words 'zhong guo you ji chan pin' (Chinese for 'organic product') or the English word 'organic.' The standard deals with the use of organic ingredients, providing that only those products using 95% or above in their production process may use the word 'organic' on their packaging. Those using between 70-95% may use the term 'you ji peiliao shengchan' (Chinese for 'produced with organic ingredients').

The industry in China has paid some attention to the concept of organically produced wine, although its presence and recognition in the market is unknown.

TECHNICAL STANDARDS FOR WINE

As mentioned in the article, the Chinese Government proposes to introduce a revised national technical standard for wine later this year. We set out below our translation of the 1994 standard, still in effect at present. A summary of the proposed revisions follows.

*1994 Chinese National Standard for Wine (GB/T15037-94)
Proposed revisions to the National Standard for Wine –
GB/T15037-2005*

Definitions

The definitions in the proposed new standard have been adapted from the original standard (GB/T15037-1994) with reference to the OIV (Organisation Internationale de la Vigne et du Vin) Regulations and the Grape Fermentation Technical Rules of China. New categories of wine have been

added – premium wine, ice wine, high fermentation wine, filtered wine, low-alcohol wine, non-alcoholic wine, and mountain wine. Added definitions for vintage wine, variety wine and local wine; sweet wine allowed grape juice concentrate, and white sugar; especially emphasised in the definitions are the banned synthetic colouring agents, sweetening agents, flavouring essence and thickening agents.

PRODUCT CLASSIFICATION

In addition to the original classifications of colour (white, rose, red) and CO₂ (ie. still or sparkling/aerated wine), sugar content is now another category.

SENSORY REQUIREMENTS

Because flavour-enhanced wine has been merged into the special categories of wine, no sensory requirements for this wine are described. Special wines will have their own appropriate standards.

Regarding fragrance, in addition to the terms ‘pure, elegant, happy’, and ‘fruity’ in the old standard, there is added ‘newly-fermented wine should not carry the description ‘newly-fermented fragrant’’. Regarding characteristics, the standard is revised to read, ‘Must have description of wine variety and product type, and should have special characteristics and style.’

Physical and chemical requirements

For special wines, the physical and chemical requirements are not included here.

This paper has been prepared by Andrew Thomson and Jeanine Marshall of legal firm, Minter Ellison. Professional advice should be sought before applying the information to particular circumstances.

⁴ Grape content in this context refers to the actual amount of grape juice excluding wine sugar content. The purpose of this minimum standard is to exclude so-called wine made merely with flavouring essence and not from actual grape pressings. Henceforth only wine made from real grapes may be called ‘wine’ (putao jiu) in China.

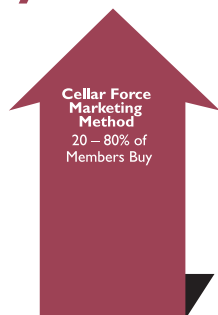
External Appearance		Requirement
Colouration	White	Almost uncoloured, pale yellow, light yellow, grain-coloured, golden.
	Red	Ultra-red, deep-red, ruby-red, reddish-brown, brown.
	Rose	Pink, light rose-coloured, light-red flavour-enhanced deep-red, brown, light-red, golden, light-yellow.
Transparency		Transparent, lustrous, no obvious suspended solids, (for cork sealed wine, less than 3 pieces of cork residue of 1mm or less size).
Corbonation		When bottled, sparkling wine should have a closely-clustered carbonation and sustainability.
Fragrance and flavour		
Fragrance added wine	Non fragrance	Pure, elegant, pleasant, harmonious and fruity.
	Fragrance added wine	Fine, pure wine, harmoniously aromatic.
Flavour	Dry, semi-dry	Pure and clean, elegant taste.
	Sweet, semi-sweet	Sweet mellow taste, aged flavour, harmonized acid-sweet, full-bodied.
	Sparkling wine	Fine mellow, elegant, special fermented sparkling flavour, sharp-tasting.
	Aerated sparkling wine	Clean, happy, pure.
	Fragrance added wine	Mellow, gentle, harmonious-fruity, full-bodied.
Characteristics		Prominently and clearly labelled.

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