



# 7

## The Argentinean Wine Industry

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### 7.1 Introduction

In the last three decades, the Argentinean wine industry has experienced a dramatic change in its value-added chain. In the 1990s it opened its economy, and very important foregoing investors came to the wine sector. At the beginning the most important change took place in the vineyards. A special situation in the exchange rate then allowed the wineries to go to export markets and introduce the wine successfully in the most sophisticated markets. At the same time, some wineries introduced Malbec, which was welcomed by consumers. This caused a drastic change in the Argentinean wine sector that became a competitive player in the wine market worldwide. The recent years have been very difficult for the Argentinean economy, and many wineries have had to adapt the business to new conditions, especially in the domestic market. Nowadays the Argentinean wine sector structure is very different, and the wineries and producers have the challenge to grow in a very competitive market with opportunities and very strong threats.

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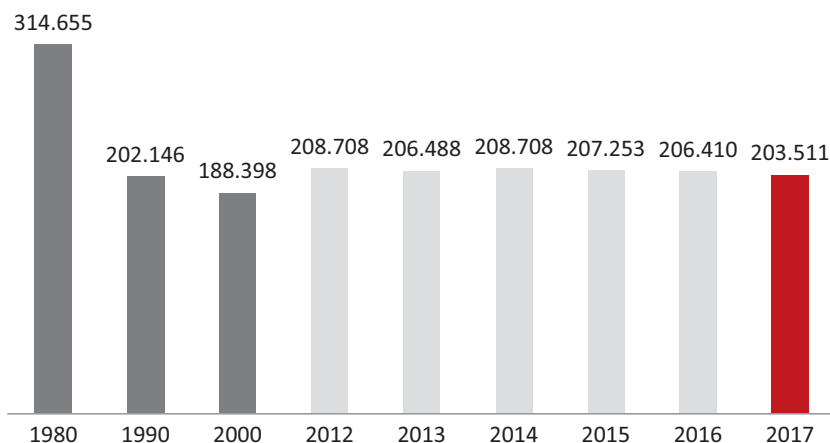
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## 7.2 Structural Features of the Vinegrowing Sector

### 7.2.1 Evolution of Vineyard-Planted Areas

Argentinean viticulture has experienced a major transformation process over the last two decades, showing a substantial increase in wine quality and establishing a firm foothold in the international markets. This transformation began in the vineyard, back in the 1980s, when a maximum of 315,000 ha (777,000 acres) were planted (Fig. 7.1), a large portion of which were low-quality grapevines that had been planted almost exclusively for the domestic market. With little to no international placement, the consumption of low-quality grapes soon began to decline.

The first half of the 1980s was witness to a vine-uprooting process, the aftermath of successive crises, production surpluses, and low prices subsidized by the national government. When combined with a variety of political interventions, from strict regulation policies to grape purchases by the State, none of these events contributed to a profitable activity. Soon after the uprooting of almost 100,000 ha of vineyard-planted areas (250,000 acres), in the year 2000, only 188,000 ha (465,000 acres) remained, despite an ongoing process of planting newer and higher-quality vineyards in order to improve wine quality for export purposes.



**Fig. 7.1** Evolution of cultivated surface area of grapes for winemaking in Argentina (ha). (Source: INV)

From 1990 to the present day, the cultivated surface area of high-quality varieties has increased by almost 4600 ha (11,300 acres). However, when analyzing the nine most purchased varieties for export (Malbec being the leader), their growth in particular has increased to more than 77,000 ha (190,000 acres), while other varieties have fallen by more than 72,000 ha (178,000 acres).

### 7.2.2 Regional Distribution

Traditionally located on the west of Argentina, wine-producing regions are strewn along the foot of the Andes mountain range, a feature that has translated into a unique and special prestige associated with the grapes and wines coming from the said regions. Although wine grapes are grown in 17 out of 24 provinces in Argentina, Mendoza ranks first in terms of wine production, representing more than 71% of the country's total vineyard-planted surface area and stretching over four oases from north to south. Argentina is one of the countries with the highest latitude dispersion of vineyards. Mendoza is followed by San Juan and La Rioja provinces in terms of wine production. In the last few years, new provinces added to the list, notably Neuquén in the Argentine Patagonia.

### 7.2.3 Growth of Wine Provinces

Argentina's switch in grape varieties went hand in hand with the adoption of new technologies in the irrigation systems, which additionally expanded the planted surface area in inadequate vinegrowing regions where traditional irrigation methods were otherwise not possible. This spurred Argentine viticulture to extend to high-altitude areas and regions where the combination of thermal amplitude and soils offered the possibility of growing higher-quality grape varieties, very much demanded by international markets.

Between 2001 and 2013, the provinces of Mendoza, Neuquén, and Salta revealed the largest area expansion. In the first one, Mendoza, new regions began being cultivated. Neuquén, the newest of the Argentine winemaking regions, expanded due to private investments, financial support from the local government, and optimal agricultural conditions given its latitude, sun exposure, and the presence of wind year-round. In Salta, the vinegrowing region with the highest altitude in the country, the surface area expanded in an attempt to increase thermal amplitude for the production of red varieties.

Observing the change in planted surface area and the variations of more than 5000 ha (12,500 acres) alone hides the fact that 11 regions still managed to increase their planted surface area by 26,000 ha (64,000 acres) between 2001 and 2013. Luján de Cuyo, Argentina's most traditional winegrowing region, with the largest Malbec-planted surface area, led this change by expanding to the south and west. This area is home to some of the oldest wineries in the country, along with those founded in Maipú.

## 7.2.4 The Switch in Varieties

The most cultivated variety today is Malbec (Table 7.1), due to international and national demands. While the total cultivated surface area has been increasing 0.02% annually over the last 25 years, red varieties have expanded 3.7% per year. Beyond Malbec, varieties such as Cabernet Sauvignon and Syrah, among red grapes, and Chardonnay and Sauvignon Blanc, among white varieties, have increased their cultivated surface area. Malbec proved to be the main catalyst behind this process. Back in 2017, Malbec boasted Argentina's largest cultivated surface area, even after having suffered from the drastic, low-price-driven vine-uprooting process that took place in the 1980s.

Eleven varieties were responsible for boosting this expansion. Almost all of them were red, but Chardonnay and Sauvignon Blanc played a major role as well. Closely behind Malbec, the next largest expansion was evidenced by Cabernet Sauvignon, which grew more than 12,650 ha (31,000 acres). Before the acceptance of Malbec, primarily in international markets, the most appealing vine to investors was actually Cabernet Sauvignon, mainly because it had been leading worldwide preferences since the beginning of varietal wine phenomenon in the United States. In fact, from 1990 to 2000, during the first phase of Argentinean viticulture modernization, the cultivated surface area of Cabernet Sauvignon grew almost 10,000 ha (25,000 acres), that is, two thirds of total growth, while Malbec only grew 6000 ha (15,000 acres).

Syrah ranks third when it comes to investments. With respect to this variety, investors, especially in the 1990s, focused on two signs. The first one was the considerable growth that, for some time, positioned this variety in the sphere of foreign markets, following the success of Australian exports. The second was the possibility of taking advantage of a number of tax breaks, especially in San Juan, where this variety had proven to adapt very well.

Bonarda has shown a very interesting growth period on the grounds of two notable characteristics: its easy adaptability to blend, especially with Malbec,

Table 7.1 Surface area of wine varieties (ha)

	1990 (1)	2000 (1)	2010 (1)	2017	Variation 1990/2017	CAGR 1990/2017
<i>Red</i>						
Malbec	10,457	16,347	28,481	41,301	30,844	5.2%
Bonarda	12,186	14,989	18,748	18,708	6522	1.6%
Cabernet Sauvignon	2347	12,199	17,672	14,997	12,650	7.1%
Syrah	687	7915	13,086	12,470	11,783	11.3%
Tempranillo	5659	4335	6563	6015	356	0.2%
Merlot	1160	5513	6937	5510	4350	5.9%
Sangiovese	3015	2491	2230	1713	-1302	-2.1%
Pinot Noir	232	1047	1675	2045	1813	8.4%
Tannat	42	136	578	835	793	11.7%
Cabernet Franc	76	207	578	1043	967	10.2%
Barbera	958	1061	732	426	-532	-3.0%
Other red varieties	5562	3808	5497	8496	2934	1.6%
<b>Red surface area</b>	<b>42,381</b>	<b>70,048</b>	<b>102,777</b>	<b>113,559</b>	<b>71,178</b>	<b>3.7%</b>
<i>White</i>						
Pedro Giménez	20,647	15,101	13,378	10,713	-9934	-2.4%
Torrontés Riojano	8625	8181	8480	8171	-454	-0.2%
Chardonnay	908	4625	6584	6207	5299	7.4%
Muscat of Alexandria	10,184	5539	4034	2637	-7547	-4.9%
Chenin Blanc	4031	3591	2851	2045	-1986	-2.5%
Sauvignon Blanc	278	827	2297	2061	1783	7.7%
Torrontés Sanjuanino	4914	3166	2527	1820	-3094	-3.6%
Ugni Blanc	2229	2846	2425	1495	-734	-1.5%
Semillón	1255	1028	956	728	-527	-2.0%
Other white varieties	7326	4530	4225	3551	-3775	-2.6%
<b>White surface area</b>	<b>60,398</b>	<b>49,432</b>	<b>42,906</b>	<b>39,428</b>	<b>-20,970</b>	<b>-1.6%</b>
<i>Pink-skinned</i>						
Cereza	43,100	31,666	29,934	27,971	-15,129	-1.6%
Criolla Grande	36,837	24,641	20,749	14,842	-21,995	-3.3%
Muscat Rose	15,503	10,656	8691	6185	-9318	-3.3%
Other pink- skinned varieties	3927	1956	1908	1526	-2401	-3.4%
<b>Pink-skinned grape surface area</b>	<b>99,367</b>	<b>68,918</b>	<b>55,101</b>	<b>50,524</b>	<b>-48,843</b>	<b>-2.5%</b>
<b>Total surface</b>	<b>202,146</b>	<b>188,398</b>	<b>200,784</b>	<b>203,511</b>	<b>1365</b>	<b>0.0%</b>

Source: INV

and its high yields in certain regions. For a long time now, many wineries have been trying to position this grape internationally as the second most important variety from a.

Chardonnay, on its part, fifth in the expansion of cultivated surface area, shares a similar story as that of Cabernet Sauvignon. Implanted because of its international popularity, Chardonnay can be used in producing sparkling wines, which experienced an impressive growth in Argentina, following the worldwide trends set by younger generations (Fig. 7.2).

In Argentina, Merlot suffered the same fate as that on the world stage. A once prestigious variety suffering depreciation from consumers, its extension in our country went from about 1000 ha (2500 acres) in 1990 to more than 7400 ha (18,200 acres) in 2006, to ultimately decline in 2017 to less than 5500 ha (13,500 acres).

Fascinating stories concern the rest of the varieties that expanded in the last quarter of this century, since all of them constitute modern phenomena. In

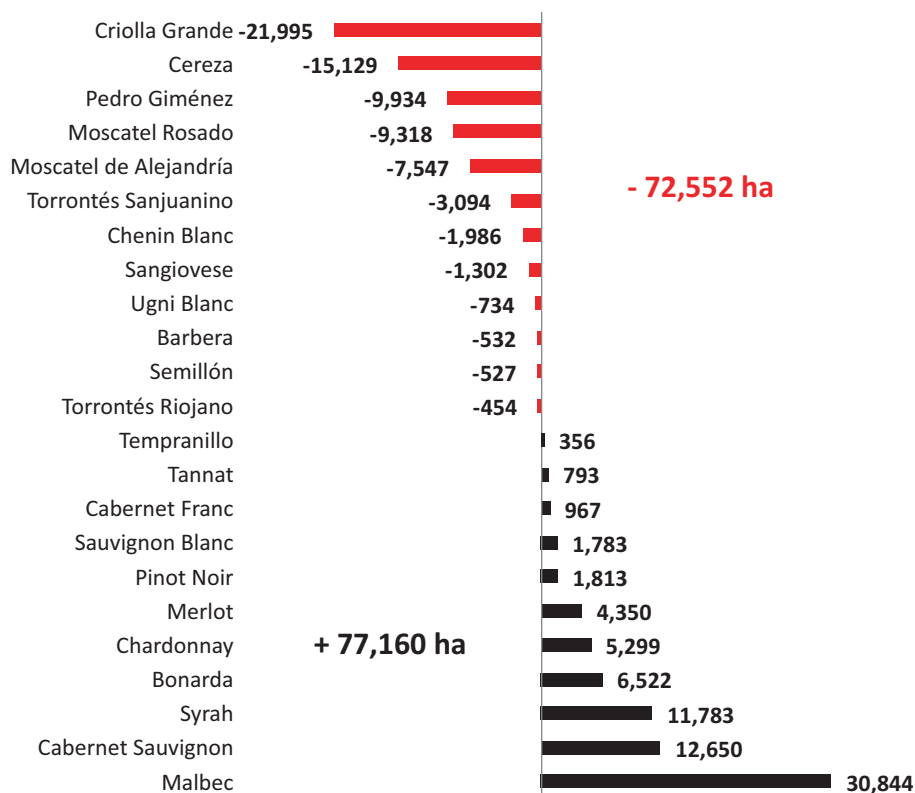


Fig. 7.2 Variation surface area (1990/2017). (Source: INV)

the case of Sauvignon Blanc, its expansion reflected the formidable acceptance it was getting from New Zealand, which led it to expand to new regions, such as Chile. Consequently, given its international popularity, many Argentinean wineries began growing this variety, contributing to expand its cultivated surface area during the first decade of this century.

Pinot Noir, on its part, has been growing uninterruptedly since 1990 for a variety of reasons, including the demand for sparkling wines in medium-to-high price ranges as well as its exceptional adaptation to regions in Valle de Uco and Patagonia. Additionally, the growing international demand for still red wines from Burgundy, France, resulted in the creation of new wine styles from the regions of Sonoma and Oregon in the United States and, more recently, New Zealand.

The decreasing cultivated surface area experienced by some varieties has been attributable to the inability to adapt to a number of consumers' demands, such as price and quality.

### 7.2.5 The Expansion Cycle of the Main Varieties

As mentioned before, several vineyard investment stages took place that matched the different market incentives and the existing surface area each variety covered when modernization began. Essentially, the said expansion process was the natural corollary to the newly acquired maturity and knowledge regarding the viticulture industry. Three periods can be identified at this stage:

1. An introduction period (1990–2000): this is the time when Argentina held an open economy policy and sought to attract investors to the activity. Export expertise was not abundant, and world market trends remained yet unclear as to how to define viticulture in the country. Incentives were in place to motivate the planting of new varieties, such as reduced prices of land and the availability of irrigation technology.

Throughout this first period, varieties may be defined as those “internationally in demand” that did not cover a large implanted area—except for Malbec, Bonarda, and Tempranillo, whose expansion rates ranged between 10% and 25% annually. The Malbec phenomenon had yet to start, although this variety already covered more than 10,000 ha (25,000 acres) at a time when other varieties, such as Cabernet Sauvignon, barely extended to 2000 ha (5000 acres), and the rest remained well below these figures.

2. The expansion period (2000–2010): worldwide sales of Argentine wine spiked on currency exchange conditions that proved favorable to foreign markets. This triggered a powerful process that entailed a change in wine consumption trends, switching from formerly demanded lower lines all the way to the higher price ranges. This period was also characterized by the primary role assigned to consumers' preferences, which were becoming increasingly knowledgeable about wine as well as more selective and focused.

This period additionally evidenced a change in the behavior with respect to the rest of the varieties. Firstly, their surface area expansion substantially reduced, as if anticipating to a maturation period. A few varieties remained the exception, notably Sauvignon Blanc, perhaps influenced by its success in New Zealand; Tannat, very much adapted to some regions alone; or Cabernet Franc, whose behavior resembled Tempranillo's when its cultivated surface area dramatically reduced in some places but experienced increase in others. All the while, Malbec continued to expand to a considerable total area of 16,000 ha (39,500 acres).

3. Maturation period (2010–present): the world market signs and Argentina's economic scenario played a decisive role in investment decisions, as companies had gained considerable commercial experience by now. The only variety to outgrow the others during this period was Malbec, reaching almost 41,000 ha (101,000 acres) in 2017 despite its uprooting process back in the 1980s. Furthermore, the expansion occurred despite Argentina's ongoing macroeconomic context as from 2010, when inflation edged up and a process of domestic currency depreciation ensued that immediately had an impact on exports, the main driver for growth. Because of low market demand, the surface area of some varieties reduced, such as Cabernet Sauvignon, Merlot, Sauvignon Blanc, and, to a lesser extent, Chardonnay. In a number of cases, these hectares have been replaced with Malbec vines. The phenomenon in Argentina is not an isolated event, and this is why it followed the tendency established between 2000 and 2010.

Cabernet Franc and Tempranillo constitute, perhaps, the two exceptions to the rule. The former, covering a relatively small implanted surface area, was a variety widely used at the beginning in plenty of French-style blends, until some wineries decided to produce it as a single varietal, something that had quite a favorable reception. Tempranillo, on the other hand, was gaining worldwide recognition because of its success in Spain, but it remained almost unknown in the New World. This, however, did not hold true for Argentina, where Tempranillo already covered a large cultivated surface area when compared to other red varieties.



The rest of the varieties showed a similar evolution, supported by the “globalization” of viticulture and the rapid adoption of innovations. A comment should be made by now regarding Malbec: although a roaring success in the United States in the few last years, Malbec has not been used to leverage the other varieties previously examined. Consequently, Malbec could be used to showcase other red and even white varieties in the future.

### 7.2.6 Size of Properties and Changes in Technology

The switch of planted varieties was further accompanied by changes in the production systems. One of the most striking phenomena behind the transformational process of Argentinean viticulture from 1990 to the present days has been the arrival of investment in the sector, largely attributable to a prospect of profitability. The vineyards covering large surface areas now expanded even further, to more than 100 ha (250 acres), while those covering less than 10 ha (25 acres) were soon uprooted. This, in turn, increased the average cultivated surface area from 5.8 ha (14.3 acres) in 1990 to 9.2 ha (22.7 acres) in 2017, which contributed to and improved productive efficiency.

The number of vineyards has increased by 1.2% annually since the year 2000, in a context where larger estates evidenced higher growth rates than the smaller establishments. A survey conducted in 1990 revealed the existence of 36,000 estates. In 2017, however, slightly more than 24,000 estates remained, showing a 30% decrease and, consequently, the concentration of vineyards among fewer estate owners. Many of the wine producers who abandoned the activity did so because their small-scale production, based on growing table-wine grapes, was no longer profitable.

Besides the increase in size, Argentinean vineyards experienced a change in technology as they began incorporating modern irrigation and protection systems (especially against hail) as well as new vine training systems. Today, most vineyards resort to the pergola-training system, currently used in more than 121,000 ha (300,000 acres), although the last few years witnessed the expansion of the trellis system, now covering more than 79,000 ha (195,000 acres)—a similar figure as that of high-quality wine grape expansion.

Across certain warmer areas of Argentina, the vine pergola-training system is the preferred option to improve grape protection, even though higher-quality vineyards will typically make use of the trellis system.

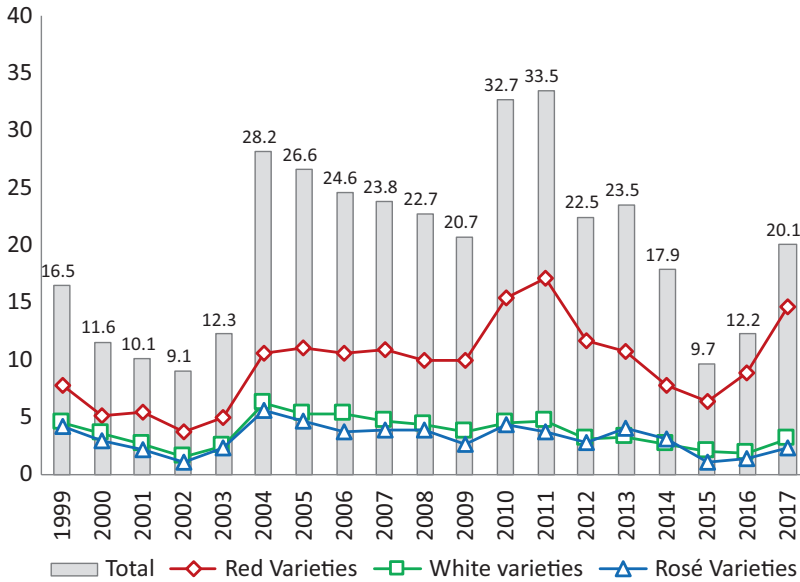
### 7.2.7 Raw Material Market

Argentina's raw material (grape or bulk wine) market is very well developed. In the last decade, about 25% of the grapes intended for wine production were sold to independent producers. In addition, about 8% of the total represented bulk wine sales from wineries that were not able to bottle their production on their own. In other words, the raw material market accounts for one third of the total number of bottled wines. Given the type and quality of raw materials, the bulk wine market is intended for low-price wines, while the grape market aims at medium- to high-end wines. The former market involves estate owners who have made large investments in their production in order to meet the large wine producers and bottlers' requirements. Lastly, it should be mentioned that high-quality grapes, intended for high-end wines, are generally grown by the same wineries that make and bottle the said wines.

The grape market is typically managed by means of agreements between wineries and producers. Some have been able to maintain their commercial relationship to this day, after many years of business. The larger wineries will regularly visit the vineyards and make suggestions on vineyard management. Great trust is developed in this type of relationship, since most grape prices will be defined after the harvest, once the wineries have already crushed the berries. In the case of bulk wine, many wine agents will offer the product to different potential buyers and receive a commission upon closing the deal. Finally, some producers who do not bottle their own production will normally grow their grapes in wineries and ultimately sell their wine to them.

### 7.2.8 Revenue in the Primary Sector

The total revenue of the viticulture sector has been calculated taking into account the figures for grape sales and the considered value of the finished product owned by the wineries. Over the last 15 years, oscillations in grape prices and the sector's strong transformation process have been two important factors affecting revenue (Fig. 7.3). In its early stage, the participation of red grapes was nowhere near the levels it would reach between 2004 and 2009. In these years, red grapes were able to maintain their revenue due to productivity expansion and stable prices. In 2010 and 2011, wine producers' turnover increased because of the price spike due to the scarce availability of grapes, the grim result of two consecutive poor harvest seasons. At that time, the demand for red grapes shifted to regions where prices were lower.



**Fig. 7.3** Annual revenues in the viticulture sector (BB AR\$ - Dec. 2017). (Source: Area del Vino)

As from 2004, the demand for varietal wine exports grew significantly. This, in turn, increased the sector's profitability and boosted expansion given the advantageous exchange rate in place.

The decline in pinked-skinned grape production has been independent from economic transformations and is rather the result of opposite international and domestic demand trends.

When calculating the average revenue per hectare across different varieties, Malbec comes across as the outright winner, outperforming every other variety given its greater expansion process. Pinot Noir ranks second, although it should be noted this variety is much more developed in certain regions.

## 7.3 Structural Features of the Winemaking Sector

### 7.3.1 Average Winery Size

A study conducted by the Argentinean Viticulture Observatory (Observatorio Vitivinícola Argentino) classified different companies operating in the viticulture market. The indicator used was the companies' commercialized volume

for each establishment in the country. A “domestic market profile” or “export market profile” was created and assigned depending on the companies’ main line of work. The study did not include wineries selling bulk wine alone, as they were considered to belong to a niche market that sells wine to the same wineries that will later on commercialize it as a finished product.

Additionally, the wineries were classified according to the size of their annual volume production into the following categories: small (less than 1 million liters), small/medium (1–4.99 million liters), medium/large (5–9.99 million liters), and large (more than 10 million liters). In Argentina, there are 719 establishments, 62% of which (477 establishments) showed a domestic market profile, while the remaining 272 tended toward the export profile.

Mendoza played a significant role in terms of total figures, especially in the ratio of total export production, which is clearly different from that in other provinces. Out of the 568 establishments registered in Mendoza, 58% fall within the domestic market sphere while 42% exhibit an export profile. When analyzing them by size, most of the establishments with an “export profile” (216 out of 239) are small (with a production volume below 1 million liters per year). Twenty wineries fall within the intermediate range, and only three have been described as large (producing more than ten million liters per year). The large establishments with an export profile manage 72% of the total volume, whereas the small ones participate in only 8% of overall production.

The majority of cases in Mendoza, 329 establishments in 2013, have a domestic market profile. When classifying them by size, small companies, once again, comprise 87% of the total. At the other end of the continuum, 15 wineries fall under “large companies”, while only 29 are intermediate. The other vinegrowing provinces offer a very different panorama, predominantly oriented to the domestic market, except for the province Neuquén, which shows almost even proportions between domestic and external profiles. The provinces of Salta, Catamarca, and Río Negro all show a strong predominance of domestic market wineries (more than 80% in the total number of companies and more than 95% in terms of volume). San Juan, the second largest vinegrowing sector in Argentina, features 75% of its wineries with a domestic profile (45 establishments) that makes up for 96% of the province’s total volume. San Juan also features 15 companies with an export profile (25%) that accounts for 4% of the province’s total volume. In the case of La Rioja, figures reveal a small number of overall participants: only eight establishments, five of which have a domestic profile and, three, an export profile.

A comparison between the results found in 2013 and those in 2005 reveals a tendency toward reducing the share of domestic-market-profile companies while favoring that of export-market-profile companies. This is evident in the cases of

Mendoza, San Juan (showing a drastic change in this respect), La Rioja, Río Negro, and Neuquén. Salta and Catamarca, on the other hand, displayed altogether an opposite situation. With respect to the company distribution according to size, no significant differences were observed between 2005 and 2013.

### 7.3.2 Strategic Focus

The Argentinean viticulture industry operates with different strategic focuses, partly influenced by the favorable export market that has been in place for the last two decades. Actually 350 companies devote themselves to export, while only 190 operate at a purely domestic scale. Large macroeconomic changes have caused a certain turmoil for wineries' strategic positioning, which today require a more competitive focus.

Figure 7.4 illustrates a focus group composed of 91 wineries (chosen by Área del Vino Consulting Group) representing more than 75% of Argentina's

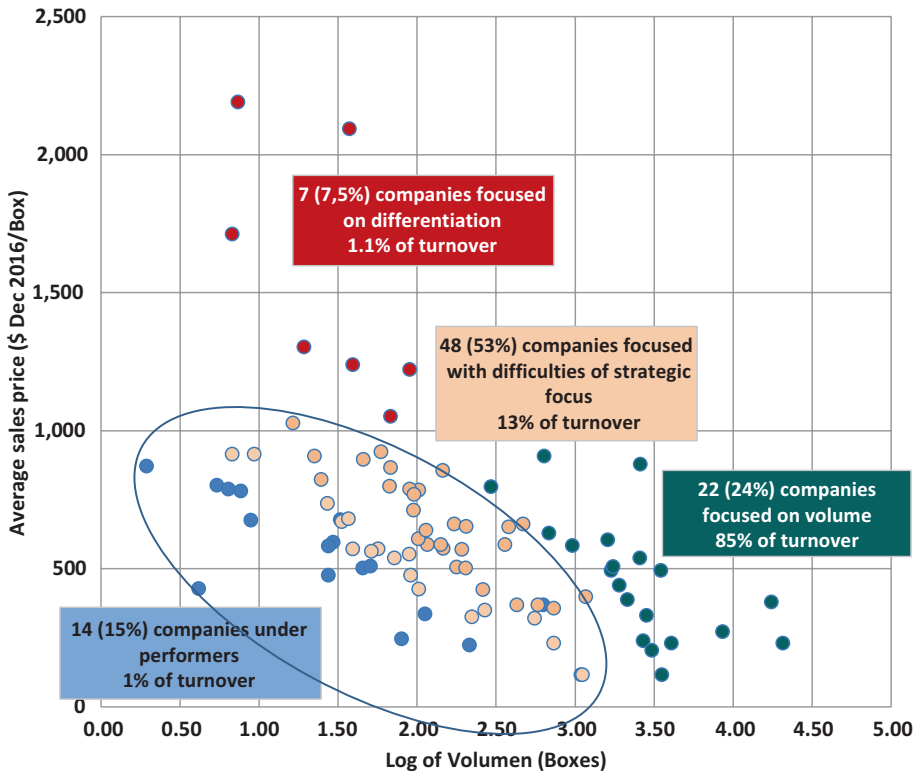


Fig. 7.4 Sales price vs. volume. (Source: Area del Vino)

wine total revenue and showing a traditional representation of price quantity. Based on the said diagram, the following conclusions can be made:

- 7.5% of companies focus on elevated prices.
- 24% of companies focus on high volume.
- 68% of them lack competitive focus—increased competition will affect them considerably.
- Companies focused on differentiation need to work actively on marketing and inventory control.
- Companies with strategies in volume need to work on consolidating their position by means of an active price policy.

### 7.3.3 Origin of Capital

Today, 31% of viticulture companies in Argentina constitute foreign investment operations, whereas 69% correspond to Argentinean capital. The arrival of foreign investors occurred mainly during the 1990s and ended between the years 2000 and 2005.

Among Argentinean companies, 65% are corporations, 30% constitute family-owned businesses, and 15% are cooperatives. It should be noted that the smaller cooperatives have joined and merged into the Argentine Federation of Viticulture Cooperatives (FECOVITA), currently positioned as one of the largest companies in terms of total sales. With respect to family-owned wineries, some have been operational in the country for more than 100 years, with the vast majority of them tracing back their roots to Italian or Spanish origins.

Lastly, the main foreign investors who own wineries in Argentina are from Chile (32%), France (21%), Austria (11%), the Netherlands (7%), and Portugal (7%). The last few years have also seen the arrival of investors from countries such as the United States, who have purchased small wineries.

### 7.3.4 Internal and External Variables Affecting Profitability

1. **Consumer preference:** transformations in the global and domestic demand for wines have been intimately connected to changes in consumers' preferences. This is true of many countries, especially in the New World, where varieties that can adapt to these preferences are often created. Vineyards in Argentina experienced a restructuring process, especially between 2000 and

2010, similar to that experienced worldwide. The expansion of Malbec accounts for a striking difference and one that may largely explain the success of Argentinean wines. Argentinean wines constitute a local phenomenon whose promotion to other winegrowing regions took a relatively longer time. However, the demand for Malbec will continue to grow in the years to come, although perhaps not at the same rate as before.

2. **Production cost:** Argentinean viticulture faced a marked tendency toward increasing costs in the last few years, due to the rising labor cost relative to wine and grape prices. This, combined with the increasingly difficult management of human resources, especially temporary workers, resulted into the considerably widespread mechanization of harvest.
3. **Fall in demand of export wines:** Argentinean wines experienced double-digit growth rates until 2010, when the consequences of several macroeconomic changes pushed up inflation. Policies seeking to change foreign exchange rates as from 2010 have delayed exchange rate adjustments, making export operations difficult. Consequently, low-price wines lost competitiveness and were left outside export operations, an event that had a negative impact on the price of the raw material that was acquired largely by the grape-producing wineries.
4. **Fall in domestic demand:** grape varieties covering large acreage were intended for medium- and high-end wines, both in the global and domestic markets. In recent years, recession in Argentina has taken a heavy toll on consumers' income, bringing the demand for wine and grapes to a grinding halt.

For a few years now, the volume of wine sold in the Argentinean winemaking sector has been declining. A decade ago, 40 million extra wine cases were sold with respect to today. However, the domestic and export markets reported a dramatic decrease five years ago, and, in 2017, the total number of wine cases sold was 125 million.

With sporadic variations, Argentina's domestic market has been declining over the past 30 years. It finally reached a plateau in 2008, making any price changes directly dependent on price movements experienced by the products placed at the lower half of the wine pyramid, especially regarding Tetra Brik wine shipments. In parallel, the foreign market has shown a reduction in volume, both for bulk and bottled wines. In 2016, in total, this number has hit its lowest mark in the past decade.

The combination of smaller volume and lower prices led the industry's total revenue to a sum below that obtained in 2006 and 18% below its all-time high, recorded in 2011. The industry has been suffering consecutive decline

in sales for five years in a row, resulting in very serious effects on several fronts, including:

**The Fall in Grape Price** The price of raw material is one of the main items affected when revenues decline. An asset with no alternative use in the current economy, its value is flexible, unlike that of other goods and services consumed by the industry. As a consequence of low prices, winemakers have had to cope with a very harsh reality in the past few years, sometimes working despite evident losses, which resulted in disinvestment and lesser quality. Smaller wineries, however, were less likely to transfer this adjustment to vinegrowers as they have a larger proportion of their own grapes for winemaking.

**Disinvestment** Between 2010 and 2015, according to information provided by wineries and collected by the Wine Division from Banco Supervielle, the industry's total assets fell about 19%, while fixed assets fell by 33%. This means that the industry today shows one third less competitive capacity in terms of investment operations in vineyards, machinery, and other fixed assets.

**Concentration** As with every economic process subject to adverse external conditions, the sector tends to concentrate on the stronger companies that show a better capacity to resist these conditions. Five years ago, companies whose sales worth was above ARS 500 million per year represented more than 78.7% of sales of the Argentinean viticulture industry, whereas now they represent 81.3%.

## 7.4 Distribution and Relationship Along the Distribution Chain

### 7.4.1 Argentinean Wine Markets

Of the 125 million cases sold in 2017 (Fig. 7.5), 80% were destined for the domestic market. In terms of revenue, this meant 64% revenue originating from the Argentinean market and 36% from export operations. This clearly shows the difference between export and domestic prices, the average export prices being much higher than the domestic ones. Argentina has been increasingly concentrated on producing wines for the medium- to high-end price ranges in global markets.



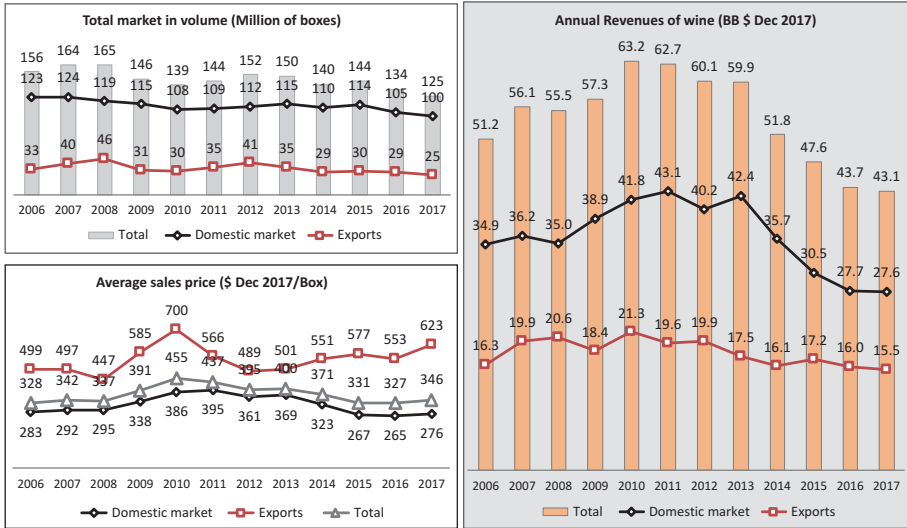


Fig. 7.5 Total market in volume (millions of cases), average sales prices (AR\$ Dec. 2017/case), and annual revenues of wine (BB AR\$ Dec 2017). (Source: Area del Vino)

When it comes to destination countries, the United States has been the most significant one in the last few years, importing 32% of Argentina’s total bottled wine exports. The United States has been a steady and very dynamic market for Argentinean exports, especially due to Americans’ preference for Malbec. In the second place, the United Kingdom accounts for 18% of the total export operations. Argentinean wines experienced a substantial change in focus in the UK market over the last decade. In the last years, efforts have been directed to importers with large participation shares of on-trade sales as well as off-trade chains with higher prices. After many years of continuous hard work, China has become a top market, joining Canada, Brazil, and the Netherlands.

### 7.4.2 Changes in the Domestic Market

The domestic wine market has followed behavioral patterns that mirror those of the global markets. For more than a decade, international discussions have ensued about the changes in consumer habits leaning toward higher-price wines, a phenomenon known as *premiumization*.

Several causes may help explain this change: firstly, older generations, with higher incomes, are slowly evolving into connoisseurs who are willing to pay higher prices for the wines they seek. Additionally, the 2008 crisis largely

changed at a global scale the amount of wine that was consumed at home versus that which was consumed outside. Rather than paying high prices at restaurants, consumers prefer to buy wines on off-trade channels, which entails the possibility of purchasing higher-quality wines at lower prices when compared to hospitality establishments. This behavior, which started after the crisis in 2008, has remained valid until the present days.

In the case of Argentina, this process has been more accentuated, as the price pyramid started at a lower baseline than that of other countries. The total volume of wine consumption fell at an annual rate of 1% in the last decade. In this context, consumption of low-price wines, sold in Tetra Brik packaging, fell at an annual rate of 1.8%. However, bottled wine grew at an average of 1.2% annually, an early sign of *premiumization*. The phenomenon becomes increasingly evident when analyzing the evolution of bottled wines across different price ranges. Those at the bottom range (ARS 164 per case) fell at a rate about 5% annually, while the top price segment (ARS 835 per case) increased their volume at an annual average rate close to 19%.

It should be highlighted that sparkling wines and *frizzes* (sparkling wines typically aimed at a fun, young adult segment) have expanded greatly. This event not only signals a *premiumization* but also a change in consumers' behavior. Consumers seem to be shifting from still to sparkling wines, which additionally constitute a strategic introduction of a younger audience and of women into the wine market. This very marked change had a positive impact on those wineries leaning toward premium wine lines, as they could now improve their profitability. In turn, the wineries working in the lower price segments resorted to more aggressive strategies in order to maintain their position on the shelf, hoping for better consumption habits worldwide.

Despite the impressive sales growth volume evidenced by high-end wine lines, they still represent a small percentage of the total. In 2016, bottled wine accounted for almost 55% of the total volume, while higher price ranges, at ARS 422 per case, accounted for only 7.6%. The share of sparkling wines is about 4.6% of the total of volume. This market sector, it should be noted, represents 12.2% of the overall market that breaks down into 200 wineries that produce a total volume of 13.6 million cases, with an average of 68,000 cases per winery, figures obviously much higher for large wineries.

In the domestic market, the revenue derived from bottled wine represents 76% of the total revenue, and it has been growing at an average rate of 2% per year. The bottled wine market is clearly very attractive for investment, proudly showing considerable revenue both domestically and internationally. Due to their higher prices when compared to those available domestically, external markets have offered substantial investment opportunities.

### 7.4.3 Sales Channels in the Domestic Market

The current domestic wine market may be characterized as relatively saturated and highly competitive. A variety of elements serves to illustrate the said features:

**Retraction from the Market** Over the past decade, the domestic wine market has been declining in volume. Given the projections for population growth, this scenario will ultimately create a market that becomes saturated with brands and competitive wineries.

**Reorientation of Businesses and Wineries** Many wineries that became operational during the time of favorable exchange rates and that worked almost exclusively for international markets have to revise and change their strategy, which translated into a significantly increased competition in the domestic market.

**Rise in the Commercial Chains' Negotiation Power** Commercial channels, especially large supermarkets, commercialize a relatively small portion of the total number of brands and wineries. The requirements for inventory rotation are essential for these sales channels, but few wineries have the capacity to comply with the said conditions. Many wineries do it to promote their brands, but as they begin to lose profits from a given channel, the endeavor becomes less appealing from a business perspective.

**Discount Policies** With sales plummeting over the past few years, the business strategies designed by large retail alcohol beverage stores and wine shops aimed at offering discounts and special sale prices. These strategies are often devised by the stores themselves, in an attempt to attract new clients who will buy other products or who will contribute to product rotation. These strategies sometimes also include a variety of payment options, such as credit or debit cards, or the creation of a store club membership offering discounts to its members. Only large wineries with a large production volume, however, are able to take the impact of this type of deals, and very few can negotiate not being a part of them.

The current competitive climate is making commercialization costs grow significantly. According to a focus group covering 82 wineries, the reported commercial cost on their balance sheets was 18.9% of total sales in 2010 and rose to 21.7% in 2015. For promotional and discount-related activities, the cost for companies with a large domestic market share was about 7% of total sales.

Wineries in Argentina resort to various channels for sale. The proportion of on-trade wine sales (on-premise consumption) is about 17% of total volume, a figure similar to the worldwide average. Wineries will typically use distributors for the on-trade channel, while large-scale wineries will have their product transported directly.

Because of its promotional appeal, the on-trade channel is a very much coveted space. In fact, many wineries will seek to buy their own space into the wine lists. Beyond the type of customer visiting the hospitality establishment, measures need to be taken in order to preserve the wine properly. Additionally, wine-related sales skills are important. Furthermore, wineries should consider the risks associated with the sustainability of the hospitality business.

In the off-trade distribution channel (off-premise wine consumption), according to a survey conducted by Kantar Worldpanel in 2015, sales in large supermarkets represented 24% of the total volume and 30% of total revenue, similar to the global total. When including self-service or grocery stores with a format similar to that of small supermarkets, the proportion grew to 71% in volume and 72% in value, the difference being that self-service or grocery stores sell their products at higher average prices.

Although representing a smaller market share, alternative distribution channels are available. E-commerce stands as a very interesting option for businesses eager to sell their wine on this platform. This type of channel, albeit small, is growing at a rapid pace.

#### **7.4.4 Winery Participation in Sales Channels**

A huge challenge for many wineries in Argentina, the access to commercial venues from where to develop their winery's presence is key. Out of the 350 wineries participating in foreign markets with more than 2000 brands, only a reduced number are able to take active participation in the domestic market. The Argentinean supermarket distribution channel encompasses more than 60 companies. Of the total number of companies operating in the country, a reduced number, nonetheless, comprised by both national and international chains, represent a large percentage of total revenue.

Argentinean specialist stores, on their part, about 1000 establishments (some of these being more difficult to categorize as they sell other products as well), are scattered across the regions following the trends set by population and income distribution. However, a reduced number of specialist stores are currently working following a chain-like format, and, as such, they are running operations not only in main locations such as the city and province of

Buenos Aires but also in other regions of Argentina. Supermarkets have not been the only ones to develop online sale platforms for their customers, with leading specialist stores also developing their own, thus leading to a systematic and continuous growth in e-commerce.

With respect to winery presence in supermarkets and specialist stores, a small sample has been gathered, composed of the largest companies from each category, accounting for a total of 13 businesses, many of whom work jointly with chains throughout the country or have developed online platforms. These large chains, then, commercialize the wines from 189 wineries, a figure that represents half of the companies that export wines.

Fifty-five percent of all wineries have access to both supermarkets and large supermarkets. In other words, these establishments are responsible for selling the wines of only 104 wineries. In the case of specialist stores, on average, they sell the products from an increased number of wineries (139) and feature wines from smaller establishments that do not run business on larger channels. Only 54 wineries participate in both channels. Incidentally, these wineries are the largest ones in the country, many of them holding a dominant position in foreign markets as well. These figures, however, fail to reveal the fact that the supermarket with the most comprehensive winery list includes only 68 establishments, while the least comprehensive supermarket, with a modest domestic distribution, lists only 40. Specialist stores, on their part, cover 134 in the best-case scenario, while only 24 on the opposite end. This analysis clearly reveals not all wineries manage to be present across all channels.

It becomes clear, then, that the main off-trade sales channels leave aside a large number of wineries with their own wine brand. Many of these wineries have no participation in the domestic market as they only perform export operations. Others, however, will sell in small regional markets, while some have started to develop direct-to-consumer sales strategies as an alternative profitable option, in a scenario where wine tourism is of outmost importance.

Only 20 wineries (some of which belong to a single economic group) represent more than 85% of the total sales of wines from supermarkets. This shows that the said wineries focus on this channel in particular and hold the power to negotiate active participation on store shelves, in addition to maintaining rotation standards and margins that signify good business for commercial venues. The explicit nature behind the power of negotiation is evident in the ratio between the price paid by the customers and the price received by the wineries. On average, wineries receive 52% of what is paid by the consumer, which is much lower than many products with less added value.

## 7.5 Conclusion

The Argentinean viticulture sector has undergone striking transformations in the last quarter of the century, from the process of uprooting low-quality grapevines covering 72,000 ha (178,000 acres) to the plantation of highly demanded grapevines extending over 77,000 ha (185,000 acres), 30,000 ha (74,000 acres) of which correspond to Malbec. Additionally, production capacity has increased, combined with the arrival of national and international investments in the sector. Finally, two commercial developments are worth mentioning: wine *premiumization* in the domestic market and their export to the main international markets. The last five years have witnessed an adverse economic context in Argentina, which has slowed down the momentum for many wineries. In the next few years, lower inflation rates and a policy for remaining open to the world will allow the Argentinean wine industry to expand and evolve into an increasingly professional industry with an even sharper strategic focus, even, perhaps, with fewer companies operating.

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