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Managing the Quality Wines beyond Policies and Business Strategies

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Abstract

The premise, which has always characterized legislation for Appellation of Origin (or Geographical Indications) as an indicator of quality wines is represented by the dogma of the real or imagined interaction between the vine variety, territory, and method of production and wine business and marketing strategies. This dogma determines the variability of the range of products and supports the thesis according to which the smaller the area of origin, the easier it is to determine product homogeneity and typical characteristics. Refuting this dogma means dismantling the European model behind DOs. The aim of this paper is to try to make an answer to the following questions: a) How to regulate the high quality wines located to the upper side of the quality wine pyramid and how to cover the gap of the EU wine policy? b) Introducing a business strategy like a new wine category - inside the GI - on the top of the quality pyramid does increase the total market size and prices of the GI? c) What will be the effect on equilibrium price and quantity within the GI? The questions could be addressed following a double approach. The first examines the quality wines follows the policy approach and describes the different level of regulation in the European scenario. The second takes as an example the history of Super Tuscan wines. The framework that supports the hypothesis and a description of the six theoretical assumptions that form part of the paper will be presented analyzing the political constraints. Here we will present the necessary theoretical background for modeling and some adaptive problems will discussions in the final part.

Keywords: Appellation of Origin, quality policies, Super Tuscan, wines

1. Introduction

In the fascinate scenario of wine sector, quality remains one of the most term frequently used and sometimes abused. Several definitions of quality have been proposed in marketing and consumer economics literature. Define quality is a much more complicated than it appears and the risk is incurring obvious concepts. Quality could be described by intrinsic and extrinsic quality dimensions and consists of objective, relative and subjective quality factors, which determine the value creating process (Hoffmann, 2002). Intrinsic quality aspects can be both detectable (like taste of food or wine) and undetectable (e.g. pesticide residues, chemical compounds). Extrinsic aspects of quality are incorporated into the product through the production process but are not physically part of it (Olson, 1977) such as price that is positive correlated to the quality (Farrell, 1980; Dodds, Monroe & Grewal, 1991; Rao and Monroe, 1989;) or brand name and shelf position (Lockshin et al. 2006), place of origin when making quality assessments (Atkin and Johnson, 2010), presentation, influence of store personnel, promotion, packaging and advertising, etc. (Milgrom and Roberts, 1986, Steenkamp, 1989). The debate on the impact of expert's opinions on quality and sale prices is more complicated for GIs wines. Opinions distort the relation between quality and price, especially as regards poor quality wines (Storchmann et al. 2012).This gives rise to a great deal of uncertainty concerning the wine's quality difference within the place of origin and their categories (Ashenfelter, 1989 and Jones and Storchmann, 2001). Grunert, 2002, 2005 developed two main approaches to defining food quality.

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The first one called "holistic approach" refers, to quality as inclusive of all the desirable characteristics that a product is perceived to have. The second, "excellence approach" defines quality only by examining specific characteristics that make a product of better quality or to follow higher standards" (FAO). According the concepts described before, we will consider as the extrinsic quality aspects the Appellation wine system and Appellation of Origin[2] as an indicator of quality guarantee by the European (EU) and national rules. The political economy mechanism that created the existing set of European quality wine regulations is shown by Meloni and Swinnen, 2013; Gaeta and Corsinovi, 2014; while other authors develops a political economy model of the size of Geographical Indications (Moschini et al., 2008; Deconinck and Swinnen, 2014). Most of the studies and researches applied to the AO follow marketing theories and focuses on the consumers' and retailers' behaviour, their willingness to pay for origin labeled or analyzes the factors affecting the positioning of wine based on the value addef wd by the DO or Geographical Indications (GIs) as collective brands. A substantial body of the literature on place of origin showed that Country of Origin affects consumer perceptions (Reierson 1966; Dornoff et al. 1974; Clarke, Ownens and Ford 2000; Felzensztein, et al. 2008; etc.). According to Atkin 2010, the origin information helps wine consumers to reduce perceived risk and more often perceived as an indicator of quality when purchasing wine. Orth and Krska (2002) found that "buyers rank country and region at the top of wine attributes, while price, type, and producer name ranked lower" (p.391). However, Akerlof (1970) and Nelson (1970), pioneering researchers in this field, shows that information asymmetries pertaining to the quality of a product are factors which negatively influence consumer demand.

This paper examines the quality wines follows the policy approach and describes the different level of regulation in the European scenario. Even if the literature described, is only a short overview, in the wine economics there is a gap about the studies on the effects of the introduction of new category of quality wines into the same GI. However the first gap is generated by the European quality policies. The regulation within GIs is reserved to the Organisation of Producers or Consortium according their rules. It means that within the GIs can coexist more quality wines typologies. The "high top quality" wine (inside the GI) is regulated only by the internal rules: the same one for all the producers. The consequence is that the producers of high top quality or icon wines doesn't often agree to share the same collective brand of the GI with the producers of low quality and cheap wine (even if it represent the base of their GI quality pyramid. The goal of this paper is to try to make an answer to the following questions: a) How to regulate the high quality wines located to the upper side of the quality wine pyramid and how to cover the gap of the EU wine policy? b) Introducing a new category inside the GI on the top of the quality pyramid does increase the total market size and prices of the GI? c) What will be the effect on equilibrium price and quantity within the GI? d) Certification bodies, Consortium, or Producers Organisations, could help to regulate the vertical differentiation between the different levels of qualities and reduce information asymmetries? Here we would only give a brief introduction to the major framework: we will present the necessary theoretical background for modeling and some adaptive problems will discussions in the last paragraph.

2. Conceptual Framework

2.1 Research Assumptions

We consider wine producing country with different typologies (or categories) of GIs and we propose seven hypotheses that are based on the theoretical framework developed in the forthcoming pages. H1) The austerity of the European model meant that many producers to develop new substitute products (here the example of Super Tuscan wines); H2) the consumer would unable to evaluate quality within the GI: most consumers lack the knowledge or skills to evaluate the differences of each products inside the GI (like Cru, Gran Cru, or Classico, Reserve, etc) and between GI in the same country (like Chianti and Chianti Classico (Tuscany); Valpolicella Classico and Valpolicella Superior (Veneto)); H3) consumers' quality perception on GI is mainly based on the standard quality in the place of origin; H4) public perceptions of terroir is linked with the size of place of origin and its production rules: small surface with a limed number of producers; H5) external factors such as micro climate conditions, soil properties,

[2] Appellation of origin is "the name of the country, region or the place used in the designation of a product originating from this country, region, place or area as defined to this end, under this name and recognized by the competent authorities of the country concerned" (OIV, 2012).

production rules and producers decision making are extremely important for the ultimate quality and composition of wine; H7) intrinsic quality attributes can be determined by the "Terroir".

The authors assume also that: a) most commonly, GI refer to the geographical names and qualifiers corresponding to the regions of production, used to designate the wines referred to in regulations, whose characteristics depend on the natural conditions, correlated to its viticulture characteristics (Reg. 1308/2014); b) GI has a defined and delimited area of production by the national body (generally, after long years of bargaining and debate between different shareholders). So we also, assume that is not possible to enlarge the area but is possible include the wines that are actually outside the GI and observing the same production and bottling rules. c) The credibility of a GI is based on a delicate balance between the objective value of the product, the capacity to communicate and promoting; the cohesion of the group of producers (within the Appellation), and the efficacy and quality of the public system that protects it. The theoretical framework that supports the hypothesis and a description of the six theoretical constructs that form part of our paper will be presented analyzing the political constrain below.

2.2 The Review of the EU wine Quality Policies

The premise, which has always characterized legislation for Appellation/designations of origin (DO), is represented by the dogma of the real or imagined interaction between the vine varieties, territory, method of production, wine business strategies (marketing and economics). This dogma determines the variability of the range of produce and supports the thesis according to which the smaller the area of origin, the easier it is to determine product homogeneity and typical characteristics – linked to the place of origin, soil characteristics, etc. Refuting this dogma means dismantling the legislative model behind DOs. The first EU regulation for quality wines was created in 1970 (Regulation 817/1970). Up until this point, quality wine was only regulated at member state level and no EU rules existed. Between the end of the 1800s and the mid-twentieth century, the French government introduced a series of domestic laws aiming to manage supply and guarantee production quality: the first decrees were to be adopted by the France government in 1935. The system of Appellation d'Origine Contrôlée (AOC) system come into force: however, the decrees not only limited the surface area of origin, but also called for a list of accepted techniques, grape varieties for each region and label required. For the EU policymaker, the basic idea was that wines with a DO would be autonomous within the wine Common Market Organisation of wine sector (CMO) and those two markets would exist; one for ordinary wine and one for quality wine (until 1999 with the Reg. 1493/99)[3]. Only in1963, Italy followed France and introduced the Denominazione di Origine Controllata (DOC). Portugal introduced its Denominação de Origem Controlada (DOC) in 1986 and Spain followed in 1996 with Denominacìon de Origin (DO) (Meloni and Swinnen, 2014; Gaeta, et.al 2015).

The protection model for DO and AOC is based on a pyramid-structured project that arranges the diverse objects of protection, or different types of wine, according to various levels, becoming more restrictive as they gradually move up the pyramid from the base to the peak (as shown in Figure 1). The bottom section contains undifferentiated products (Table wine [TW], Vino da Tavola [Italy], Vin de Mesa [in Spain], or Vin de Table [in France]), which have no link to their place of origin and are therefore subject to significant legislative deregulation. It is no coincidence that there are less production rules for these wines than DO wines. Instead, they fall under generic legislation defining what the term "wine" means and how it should be marketed. The next tier in the pyramid shows the category "Indicazione Geografica Tipica" (typical geographical indication [IGT]). It is here that a link with the place of production starts to have an effect, but the size of the area of origin means that should be only minimal interaction between vine variety and territory. The production rules for these wines contain some basic regulations: production area and grape origin, types of vine that may be used, yield per grape/hectares (with a large range), and chemical-physical and organoleptic characteristics (such as color and taste). The rules for this section are "lax" and encounter various control-related issues. As we move up the pyramid and the production area is restricted, we find the DO category (DOC, AOVDQ, etc. see notes under the figure). Here, the prerequisite of interaction, and therefore the relevant origin rules, play a crucial role. The limits of the production areas represent real walls between quality territory and the undifferentiated world of production anarchy, which lies outside.

[3]CMO is the legal and regulatory basis of European wine market covering vineyards to wine production. The first wine regulations were approved in 1962. Today, Reg. 1308/2013 CMO single covered all the agricultural products.

A place name is thus used to identify the wine and its characteristics, which are in turn defined by the delimited geographic area and specific production criteria, the so-called “cahier des charges” in France or “disciplinare di produzione” in Italy (Meloni and Swinnen, 2013).

Moving further up, there is another category represented by DOCG wines (controlled and guaranteed DO). The DOCG/AOC were reserved for wines already recognized DO for at least five years and are deemed to be of particular value. The DOCG/AOC, are usually connected to a smaller area of production and more stringent rules. The top of the pyramid is made up of another peculiar aspect: subareas. These are more restricted areas within DOC and DOCG wines (or AOC and DOCa), with even more restrictive independent production rules and parameters. They are mentioned on the label and assume a homogeneous product, distinctive of the wider area. This is closely connected to the terroir as specific soils have a certain physical homogeneity, meaning that the nature of the soil can pass on a particular characteristic to its produce, notably to wine (Josling, 2006). This term may thus be defined as the terroir, the place of production and more specifically it is often used to indicate a specific name or legally defined vineyard and the vines that grow on that terroir. An example, or perhaps a model, of this is the French term cru. In Italian legislation, there is a similar classification (although not exactly the same as the French model), which provides for diversification between areas or communes and identifies so-called “subzones”. Probably the most fitting analogy for the French cru is the (additional geographical) term, or the name of the commune, community or vineyard (in this case, the law also provides for the apposition “vineyard”). The small pyramid (Figure 1 on the left) shows the top of Italy’s wine quality according to D.lgs n.61/2010. In reality, the stronger the link with the area of origin is, the richer the system is in terms of legislative specifications and production restrictions[4].

However, if the vintage or weather or disease conditions of the vineyard do not justify the wine qualifying for a specific segment of the pyramid, it is possible to downgrade the wine to a lower category. Quite obviously, the inverse is not possible. After 29 years the wine regulation (adopted in Reg. 479/2008) reunited wines with origins into two categories PDO (Product Denomination of Origin) and PGI (Product Geographical Indication). It also aligned legislation on QWpsr into PDO (DOC and DOCG) and IGT in PGI respectively. For wines with no origin and table wines, it proposed the categories varietal wines and non-varietal wines, respectively[5]. Non-varietal wines occupy the bottom section of the pyramid, or the table wine section, and can be white, red, rosé, and sparkling wines. As a consequence of the reform, the regulatory and identity elements - which for years had clearly marked the difference between IGT and QWpsr, creating two very distinct product categories - are today weakened due to the fact that they are both governed by one set of rules. With the assignment of a category for higher quality wines, IGT wines have not only been given a new logo (PGI), but have also left the table wine category and have been admitted to the prestigious enclosure for PDO/PGI (QWpsr) products [6]

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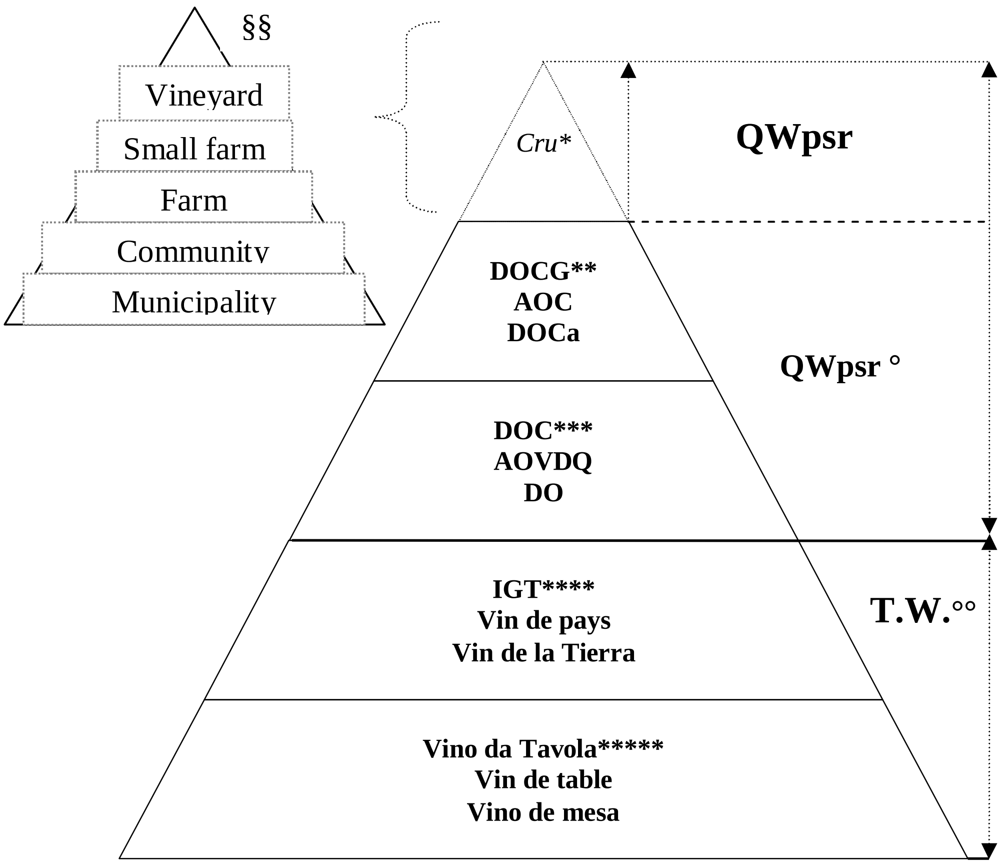
[4] Here it is worth mentioning the top Italian DOCG, Chianti Classico (Tuscany), which recently identified a new type of wine sitting at the top of the production pyramid, even above vintage wine and the “reserve” category, and providing certain chemical-physical and organoleptic characteristics: Gran Selezione. One of the main distinctive characteristics relating to the mention of the vineyard is that the chemical and organoleptic level of the parameter is measured. The indication of the vineyard (such as Castello, Villa, Chateau or Monastère recognized in Reg. 607/2009 Annex XIII is often invented by the producer as part of a marketing strategy and is therefore not only hard to trace, but is also not characteristic of the wine in terms of quality.

[5] It also provided for the possibility to the winemakers (voluntary rather than obligatory) of indicating the variety and vintage on the label for table wines. Varietal wines include on the label the name of the grape variety from which the wine has been produced and may also include the year of production.

[6] PGI wines may also include on their labels an indication of the vine variety (or a synonym) as well as the color of the wine as long as such indications are foreseen in the production protocol.

Figure 1: The "Original" Quality Wines Pyramid



Source: author's elaboration from Gaeta and Corsinovi, 2014
*Cru – Premier Cru and Grand Cru (France), Subzones or Sottozzone (Italy)
** Denominazione di origine controllata e garantita (DOCG) (Italy); Appellation d'originen contrôlée (AOC) (France); Denominaciòn de origen calificada (DOCa) (Spain)
***Denominazione di origine controllata (DOC) (Italy); Appellation d'origine vin délimité de qualité supérieure (AOVDQ) (France); Denominaciòn de origen (Spain)
**** Indicazione Geografica Tipica (IGT) (Italy); Vin de pays (France); Vin de la Tierra (Italy)
***** Vino da Tavola or Table Wine (Italy); Vin de table (France); Vino de mesa (Spain).
° Quality Wines Produced in Specified Regions (QWpsr)
°° Table Wine (TW)
§§ - The top of Italy's wine quality pyramid (Vineyards is vigna - Small farm is podere – Farm is fattoria – Community is frazione and Municipally is comune)

2.3 Business Strategies and Quality Rules: The Case of Super Tuscan wines

The overly restrictive rules created a significant transgressive tendency: an example that will be familiar to many of our readers is the fame of Super Tuscan wines. In the 1970s, some Tuscan producers came to believe that the legal rules governing the production of Chianti wines were too restrictive: they required the use of some white grapes in this red wine, and prohibited blending in non-traditional grapes, such as Cabernet Sauvignon, Merlot or Syrah[7].

[7] The local laws allowed the use of up to 30% white Malvasia grapes. The Chianti's of that years were cheap and easy to drink and often it was sold in straw covered "fiasco" bottles.

The idea of blending Sangiovese grapes with international grapes was not new; records show it being done in the 18th century. Under Italy's present DOC system, however, such wines must be labeled as table wines, considered the lowest designation of Italy's wines.

They coined the term "Super Tuscan" to distinguish their wines from the inexpensive, low-quality wines that were associated with the term table wine that they were forced to put on the label. Beyond that, it is a term more of marketing than scientific or ampelographic. In addition, a string of prestigious awards and recognition from wine critics and writers propelled the Super-Tuscans into the spotlight, with Robert Parker himself sealing their fate when he awarded Sassicaia 1985 his 100 point score (the maximum) leading prices to climb quickly. The history of the Super Tuscan is linked to two territories (both in Tuscany Region) and two families: Chianti linked to Marchesi Antinori family and Bolgheri place (on the Tuscan coast) with Marchese Incisa della Rocchetta family. Incisa della Rocchetta started to imported Cabernet Sauvignon vines from Chateau Lafite in Bordeaux and planted a vineyard calling his estate "Tenuta San Guido" and "Sassiacaia", his wine. In 1978, Sssicaia won a tasting of the world's best Cabernets held in London.

However, Antinori's family realized the potential of the terroir of Bolgheri and the usefulness of introducing new varietals. Moreover, he grasped that he could make a different wine than his Chianti and, even labeled as table wine. Bolgheri become an internationally known region following an event in 1974 arranged by Decanter (wine magazine) where six years old Sassicaia won over an assortment of Bordeaux wines. Before, Bolgheri had been relatively anonymous producers of ordinary poor white wines and rosés. In 1971, Antinori released a new wine called Tignanello, located in the Chianti Classico wine region (within DO Chianti Classico). It is generally regarded as the first Super Tuscan. The 1971 Tignanello was 100% Sangiovese, since 1975 this wine has included about 20% Cabernet Sauvignon and aged in smaller French oak barriques. Numerous other Tuscan producers saw the results and followed. Many existing wineries and several new ones started to grow grapes on the Bolgheri coast and the Chainti and Chainti Classico zone. There was no set formula for these wines. Solaia, opposite to Sassicaia with 80% of Cabernet and 20% of Sangiovese; but also Ornellaia, Masseto, (with 100% of Sangiovese); Cepparello, Le Pergole-Torte: all these wine are produced in the Chianti Classico production area but they are Super Tuscan (Sokin, 2014). In 1992, partly in response to this phenomenon, Italy added a new classification to their wines. Indicazione Geografica Tipica or IGT (see Figure 1) was created to add some level of regulation to non-DOC(G) wines. Sassicaia was also the first and only Italian wine to be honored with its own single-estate classification: thus in 1994, Bolgheri and Bolgheri Sassicaia DOC were born[8]. The case of Super Tuscan shows an interesting and double mechanism: they were born like deregulated wines based on Cabernet, Cabernet Franc, Merlot, and Syrah blending with Sangiovese and over the years have created an upside-down price pyramid: the base (labeled as table wine) were more expensive than DOC wine. In a second time, many producers have risen towards the tip of the pyramid from Table wines to geographical indication (GIs) or DOs – like Bolgheri DO. For example, Badia a Passignano was a Super Tuscan wine that's become a Chianti Classico Gran Selection in 2013 (see note 4 and below). Others like Cepparello or Pergole-Torte, still remain Super Tuscan rather than Gran Selezione. The debate is still open.

3. Discussion

Trying to answer to questions in the introduction paragraph, if introducing a new category inside the GI on the top of the quality pyramid does increase the total market size of the GI? and how to regulate the high quality wines located to the upper side of the quality wine pyramid and how to cover the gap of the EU wine policy? In wine economic s literature, authors like James and Alston, 2002, argued that there are not substitution effects on the demand size. Probably do to the fact that the introduction of a new category of high wines in GI create two markets – one for high quality and one for own quality – where the main effect could be a positive vertical expansion of prices.

[8] The sub-zone Sassicaia has its own appellation declaration, with up to 85% of Cabernet Sauvignon and 15% Cabernet Franc. Bolgheri Sassicaia must be aged for 26 months.

According to the author's experience, on the supply side the introduction of a new category of high quality wines in the GI (that already existed in their portfolio but not under the collective brand of the GI), could determinate an increase of their price without effect in the low quality wines.

The weak point of this model regards: a) the possibility for the producer to transfer his wine (from outside to inside the GI system), and the sharing the appellation objectives and policy rules: the difficulty is those to convince the producers to become his high quality wines a GI wine appellation. b) The price positioning of the new "high top GI quality wines" is coherent with quality pyramid; c) the quality standard for the "high top GI quality wines" are really differentiated from the others wines positioned at lower levels of the quality pyramid. d) The marketing strategies of the "high top quality" wines should be prevailed as a "locomotive" for all the GI wines. The opposite has happened with the Super Tuscan wines: from the beginning the business brand prevailed over the collective brand. The new possibility offered by the Chianti Classico rules seems to be more effective and practicable for the business strategies of GIs in the long run than the Super Tuscan strategies. Chianti Classico is one of the most important and oldest Italian DOs and its collective brand, "black rooster", has always been recognized as synonymous with excellence. It's the first in the world to have introduced from 2012 a new type of wine Gran Selezione DO (identified as traditional terms until now on the market only in the Vintage and Riserva mentions) at the summit of a denomination's quality pyramid with the aim to including the wines, like the Super Tuscan, that were outside the DO but with the same characteristics of Chianti Classico and also valorize the whole DO, starting from its qualitative excellence as a leverage to propel the prices towards an upward. According to the assumptions described in paragraph two, future studies should be addressed to empirically estimate the demand elasticities for "high top quality wines", with the aim to investigate the effects of a new wine on the GI system (in terms of prices and supply) and if exist a substitution effect among these wines within the same quality pyramid.

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