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A Value Chain Perspective to Understand Exports of Wine from Australia to China

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Abstract

The supply of premium wine from Australia to China is currently strong and the political economy is favourable for Australian wine to be successful. There has been considerable growth in the value of Australian wine exports from Australia to China and, in fact, Australian wine has increased its market share to become the second largest importer of foreign wine into China, behind France. This paper explores current exports of wine from Australia to China by mapping the value chain and by identifying the profit drivers. This paper also assesses the performance of the value chain with a particular focus on in-country activities designed to penetrate the Chinese market. This analysis shows that the key constraints currently within the wine value chain are cross-cultural boundaries, local representation, a lack of commercial presence within China, and pricing.

Key words: agribusiness, China, exports, premium wine, value chain

Introduction

Wine exports from Australia to China are well documented by government, industry, academics and non-government organisations. The wine value chain is also well documented in the academic literature. What this paper proposes is a point-in-time analysis using the most current data. This analysis is particularly relevant given that, in just a few months, the China Australia Free Trade Agreement is going to be in full effect with tariffs on wine being brought down to zero.

Due to globalisation and the increasing interdependency of firms, it is more important than ever to manage value chains. Networks operating on a global scale create amplified risks of disruptions being propagated through the value chain (Oke and Gopalakrishnan, 2009). The risks are such that disruptions to value chains are inevitable, which suggests that managing disruptions should not necessarily just involve trying to anticipate them, but should involve designing all inputs of a value chain to be able to respond effectively when the disruption occurs (Glickman and White, 2006). Disturbances in the value chain are more likely to be negative than positive and could impact upon the chain's performance, profitability, operating income, sales, cost structure, assets and inventories (Hendricks and Singhal, 2005).

China is the largest in many respects: it is the largest economy in the world (in terms of purchasing power parity); largest exporter in the world, by value; and has the largest population, equating to nearly one-fifth of the world's population (Bretherton and Carswell, 2001). The current population of China is 1.3 billion people on the mainland, with an expanding middle and upper-middle class. The Central Government of the Republic of China has undertaken reform and a relaxation of controls of the economy since 1978, the most significant to note being China's move to a market-based economy. Whilst still remaining a communist country in its political framework, the move to a market-based economy has brought prolific growth and opportunity.

Another important milestone to note in China's development is its accession to the World Trade Organisation in 2001, resulting in the reduction of trade barriers for member countries. Due to these economic changes, China's economy and population has become globalised and the country overall has become modernised. This has led to more sophisticated tastes and an increased appetite for Western products, which has translated into high consumer spending. The large population, the large amount of wealth and the relaxation of the economy have created significant opportunities for Australian commodities, especially wine businesses.

In 2016, the Australian wine and spirit market was worth \$3.2 billion (Wine Australia, 2018). Australian wine, among other commodities, has experienced unprecedented growth in penetration of the Chinese market. China has become Australia's principal export market, a major source of foreign direct investment and the most valuable tourism market (Lee et al., 2009). Growth in Australian products in the Chinese market has occurred only within the last decade. Australian wine companies have capitalised on the opportunity that the Chinese market presents and have become far more competitive in the market. Success has seen Australian wine overtaking key competitors in market share in China such as Chile and Italy. Additionally, whilst still second only to France in market share, Australia leads the market in the average price of bottled wine. The other key players in the Chinese market include the USA and New Zealand (ABARES, 2012; Bo Liu et al., 2014).

However, wine imported into China has to compete against the cultural preference for beer and spirits. Baijiu is still the most popular alcoholic beverage enjoyed by Chinese consumers. It is a clear spirit made from sorghum grains, such as wheat or rice, and then fermented anywhere from 30 days to 30 years. Baijiu is drunk at important events and celebrations within Chinese culture and is also integral to *guanxi*, which means networks or connections that lead to new business and facilitating business deals. Baijiu has a very high percentage of alcohol and, although still deeply embedded in Chinese culture, as the population moves to a more health-conscious culture it is anticipated that wine will likely replace Baijiu. Given the extent to which Baijiu is drunk in Chinese culture, the possibility of wine replacing Baijiu represents a significant opportunity. In particular, wine is expected to become more popular among the middle class, younger generations and business culture. A key contributing factor to this increasing interest in wine is found to be in those generations who are likely influenced by western culture (Bo Liu et al., 2014; Jourdan, 2013).

The Australian Wine Industry

Wine production is integral to the Australian economy. Australia is consistently among the world's top 10 producer countries and produces about 4 per cent of the world's total crushed wine. Australia has over 60 designated wine regions. Table 1 shows that wine is produced in all Australian states and the key wine producing states have recently experienced growth. Figure 1 shows the breakdown of wine crushed across Australia and highlights that the wine industry of Australia is dominated by three key states being South Australia (42 per cent), New South Wales (32 per cent) and Victoria (20 per cent). Queensland, Tasmania and Western Australia are clearly weaker players.

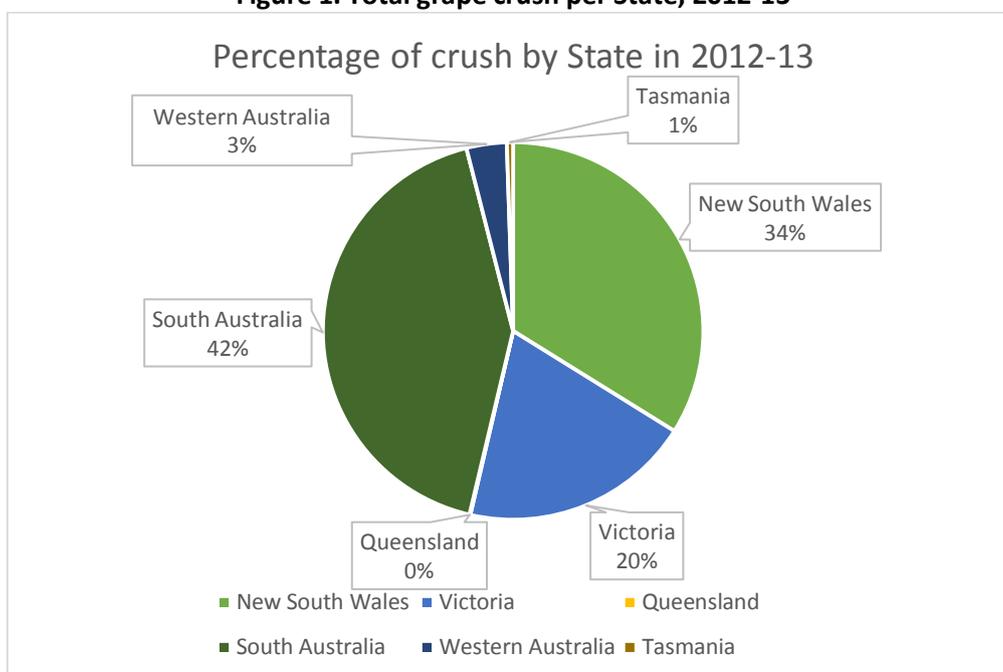
According to Australian Geographic (2018), the top five regions in Australia as a wine tourism destination are Barossa Valley (SA), Coonawarra (SA), Hunter Valley (NSW), Margaret River (WA) and McLaren Vale (SA).

Table 1. Total crush by State (tonnes)

Total Graph Crush by State	2009-10	2010-11	2011-12	2012-13
New South Wales	586,319	579,868	515,294	592,644
Victoria	250,916	260,818	305,725	344,740
Queensland	1346	700	1051	1332
South Australia	689,100	688,729	732,136	740,496
Western Australia	70,259	66,324	61,591	59,843
Tasmania	5,072	5,955	4,713	9,309
Total	1,603,012	1,602,394	1,620,510	1,748,364

Source: Australian Bureau of Statistics (2018)

Figure 1. Total grape crush per State, 2012-13



Source: Australian Bureau of Statistics (2018)

Red wine production

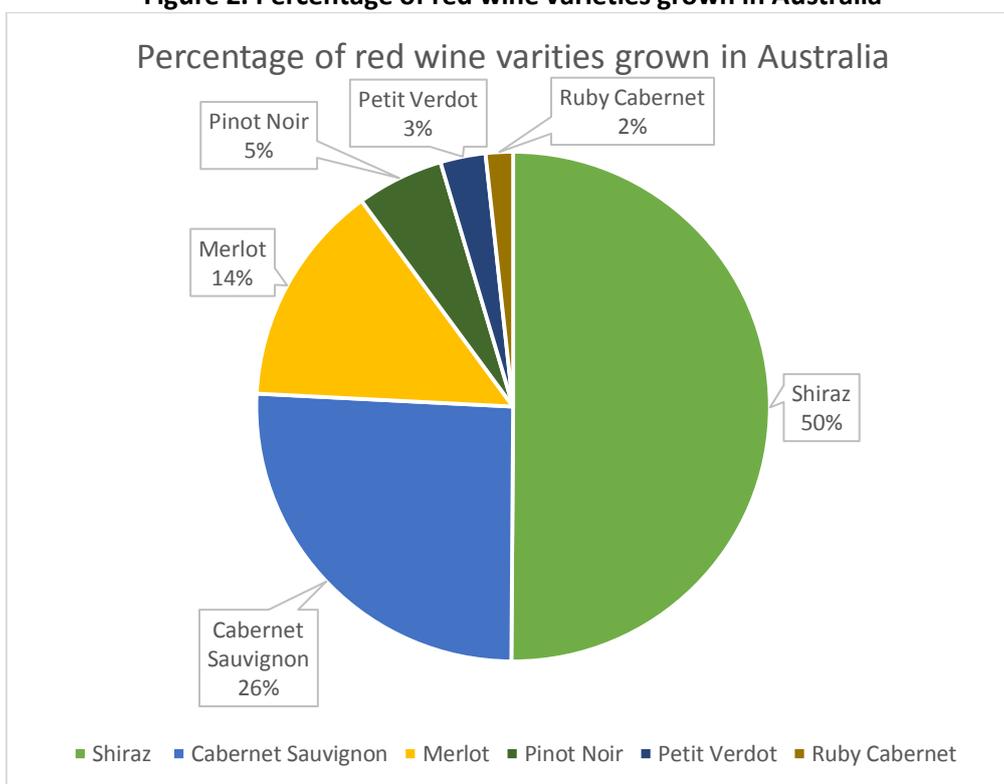
Table 2 shows that Petit Verdot has the greatest yield followed by Ruby Cabernet and Merlot. Using the production quantity for each red wine variety as outlined in Table 2, a percentage has been formulated showing the breakdown of the amount of each red wine variety grown in Australia. Figure 2 shows that Shiraz is the most popular red wine variety currently grown in Australia, followed by Cabernet Sauvignon and Merlot. In the literature, Shiraz’s popularity is documented as being derived from the stability of the red grape variety and consumer preferences, as it is an easy-to-drink wine.

Table 2. Red wine varieties, by production, bearing area and yield

Red Wine varieties	Production - t	Bearing Area - ha	Yield - t/ha
Shiraz	395,154	38,942	10.2
Cabernet Sauvignon	202,672	23,987	8.5
Merlot	111,533	8,415	13.3
Pinot Noir	43,223	4,804	9
Petit Verdot	22,434	1,117	20.1
Ruby Cabernet	13,557	848	16

Source: Australian Bureau of Statistics (2018)

Figure 2. Percentage of red wine varieties grown in Australia



Source: Australian Bureau of Statistics (2018)

White wine production

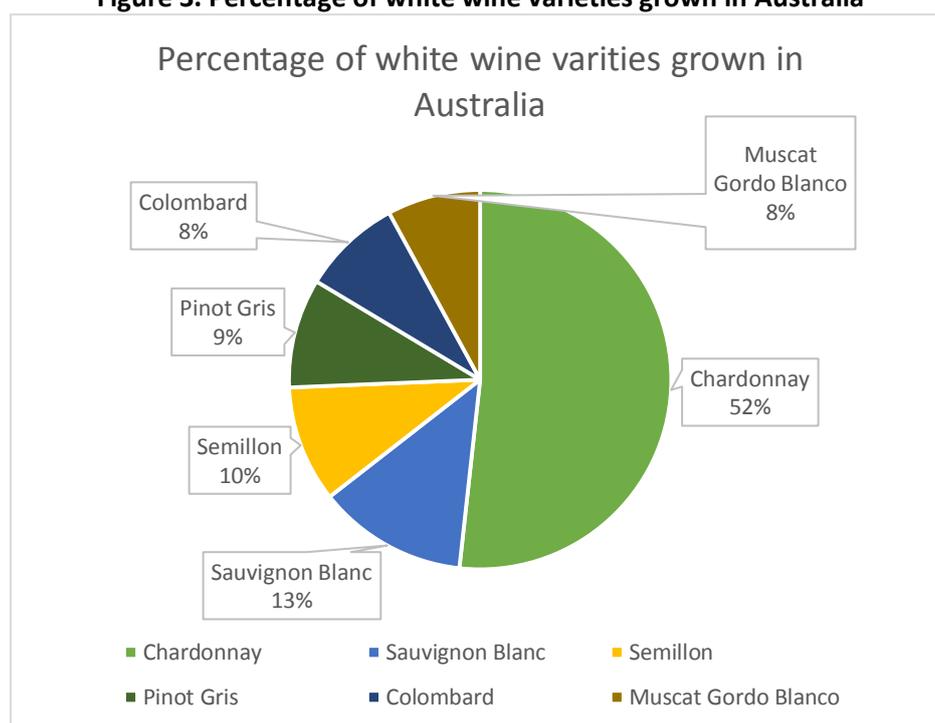
Table 3 shows Colombard as having the greatest yield, followed by Muscat Gordo Blanco and Pinot Gris. Figure 3 shows a formulated percentage highlighting the breakdown of the amount of each white wine variety grown in Australia. Out of the white wine varieties, Chardonnay is the significant leader holding 52 per cent of production in Australia. Next are Sauvignon Blanc and Semillon. Chardonnay is the most popular white wine variety in Australia and is the most popular white wine variety worldwide. Chardonnay is also the main white grape variety grown for commercial white wine production in Australia and worldwide. This is likely due to consumer preferences and because Chardonnay is a versatile variety that can be blended into a sparkling wine.

Table 3. White wine varieties, by production, bearing area and yield

White Wine Varieties	Production - t	Bearing Area - ha	Yield - t/ha
Chardonnay	340,773	21,321	16
Sauvignon Blanc	83,505	6,044	13.8
Semillon	65,411	4,555	14.4
Pinot Gris	61,387	3,651	16.8
Colombard	55,608	1,789	31.1
Muscat Gordo Blanco	52,010	2,178	23.9

Source: Australian Bureau of Statistics (2018)

Figure 3. Percentage of white wine varieties grown in Australia



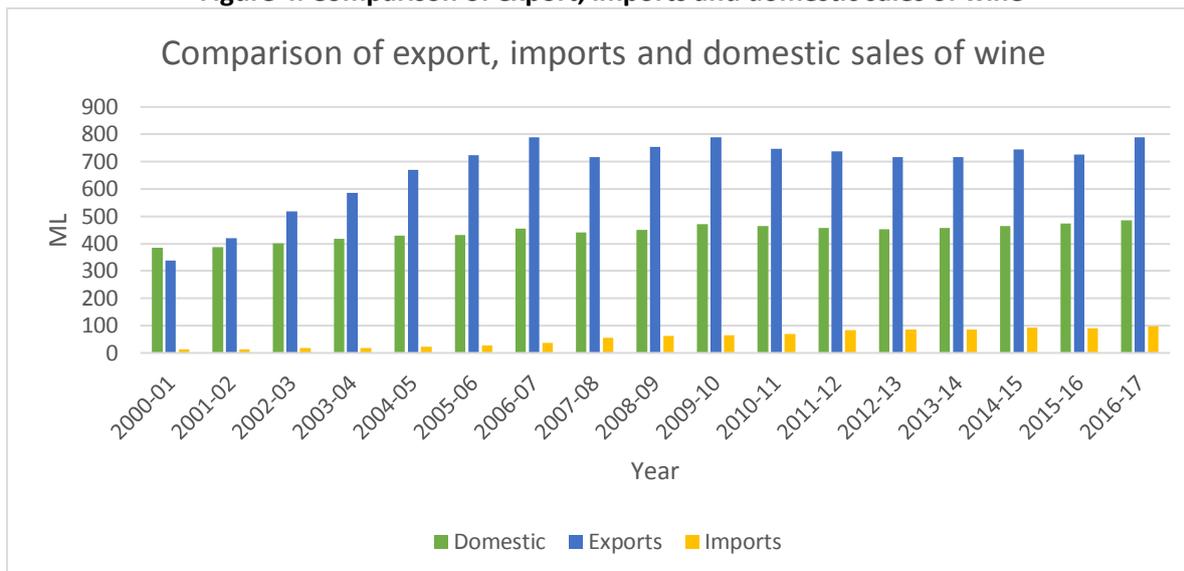
Source: Australian Bureau of Statistics (2018)

Markets

Figure 4 shows a comparison between the sales of wine in the domestic market and the export market, and how much Australia imports. The trend shows that the export market is a key market for Australian wine and imports of wine into Australia are low. The domestic market is strong, but still not as strong as exports. Figure 5 shows a further breakdown of wine exports for Australia by type and destination.

Figure 4 shows that demand has not increased dramatically in the last three years; however, Figure 6 shows that the value of exports has increased dramatically in the last three years. Therefore, it can be inferred that the sales of premium wine are driving the increase in export value.

Figure 4. Comparison of export, imports and domestic sales of wine



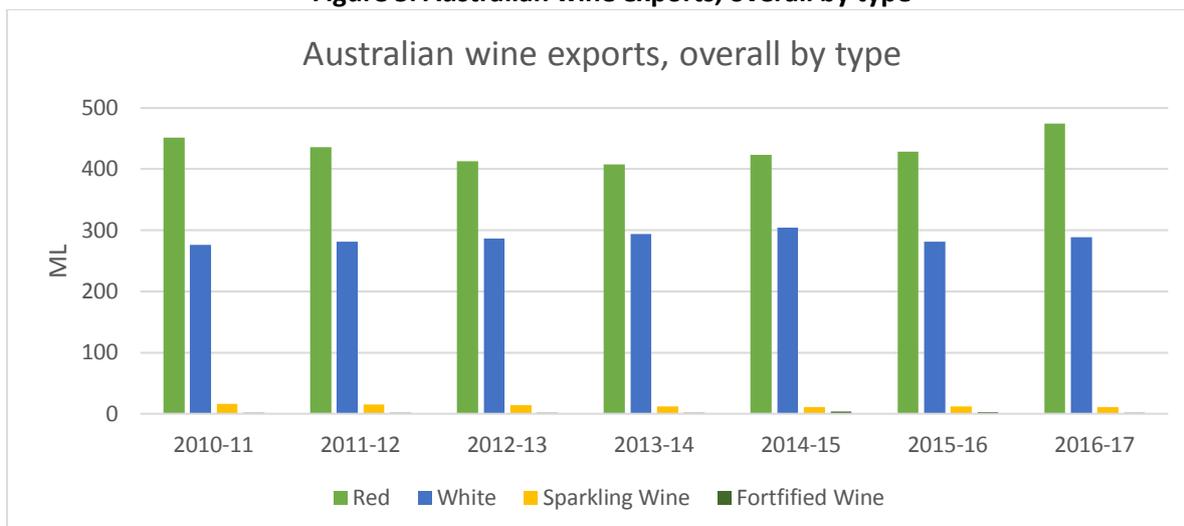
Source: ABARES; ABS, International Trade, Australia, 2018

Major Wine Export Markets

Whilst all types, including red, white and sparkling, have experienced growth in exports, the significant leader is red wine. In 2016-17, Australia exported, in total, 475 megalitres of red wine, 289 megalitres of white wine, 10 megalitres of sparkling wine and 2 megalitres of fortified wine. The data are fairly consistent between 2010 to 2016 and do not exhibit significant growth but, because no reduction in the amount exported is revealed, this is a positive.

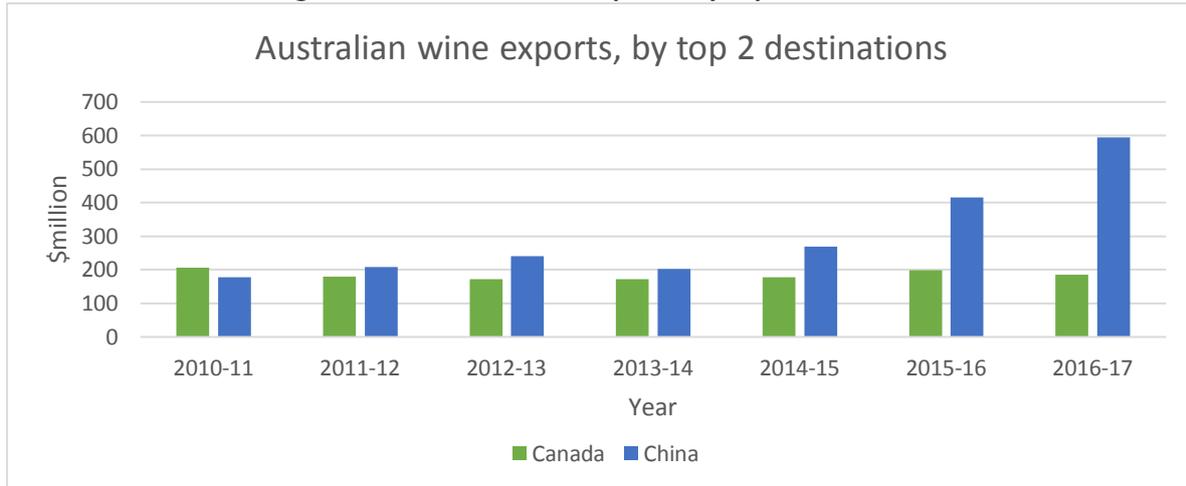
Figure 9 shows China as the most popular export market for Australian wine. The most interesting point to note is that, whilst the value of the Chinese market has grown, exports to Canada (the second largest target export market) have not exhibited any growth and instead have decreased in value. This may suggest that the export of wine from Australia is diverting from Canada to China. Additionally, exports to China have experienced significant growth since 2013, more than doubling in value.

Figure 5. Australian wine exports, overall by type



Source: ABARES, ABS, International Trade, Australia, 2018

Figure 6. Australian wine exports, by top 2 destinations



Source: Australian Bureau of Statistics, International Trade, Australia

Mapping the Value Chain

Wine has a lengthy value chain with many inputs (Figure 7). It is important to understand exactly what the division of the costs are and where they are allocated along the chain. According to Anderson et al. (2003) and Wittwer et al. (2002), the global average cost of a bottle follows this cost structure: 10 per cent to the grape growers, 30 per cent to the winery, 37 per cent to transporters, wholesalers and retailers, and 23 per cent to tax collectors.

Figure 7. Value add activity

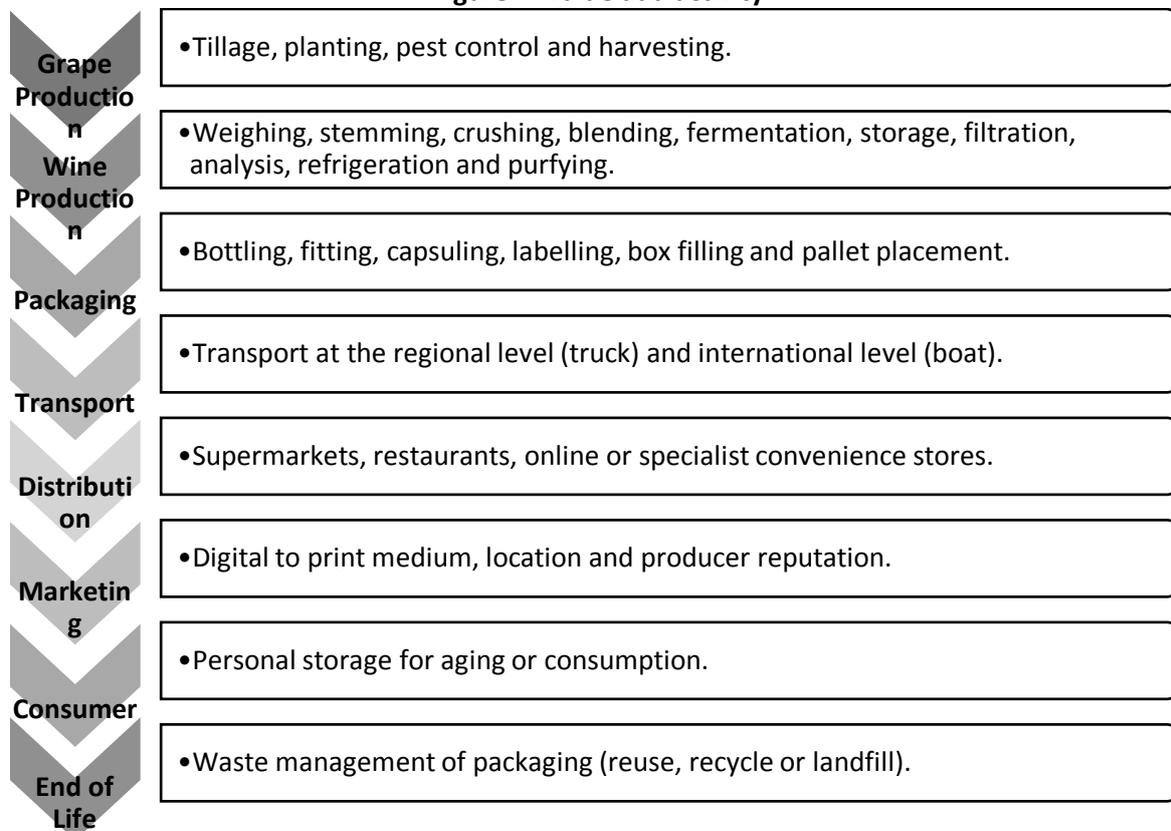


Table 4. Drivers of profit in wine exports to China

Driver	Effect
Production	
Organic winemaking style	Diversifying and tapping into new markets
Biodynamic winemaking style	Diversifying and tapping into new markets
Transport	
Provision of integrated inputs	Employ a logistics coordinator
Co-operatives	Cost effective
Distribution	
Open a cellar door/tasting room	Creates an experience for the customer and an alternative sales channel
Access to supermarkets	Higher stock turn over
Marketing	
Investing in marketing activities	Shift from solely product focused to incorporate a consumer focus
Engaging a Chinese agent	Understand the Chinese market and align activities accordingly
Tap into the gift giving culture in China	Creates a motive for purchasing
Invest in Customer Relationship Management technology	Record and manage client interactions, deal with future and current customers, optimizing and systematizing relationships
Create a wine club	Fostering a special relationship with customers

Performance of the Value Chain in China

Macroeconomic factors

Analysing the macroeconomic factors of a value chain such as taxes, tariffs and exchange rates that are not internal to an individual firm is critical for international trade and business. One such example in the current global political economy is the election of a protectionist President of the USA. The implementation of tariffs on Chinese goods and the resulting trade war between China and the USA has created uncertainty across the global economy, including for Australian businesses. The trade war that is eventuating has created detrimental conditions for American agriculture to access the Chinese market, as a result of the implementation of tariffs by China on American agricultural commodities. Some critics claim the trade war will be detrimental for Australian agriculture and other critics claim the reduction of American products in global markets will create an opportunity for Australian products to fill the void. Whatever eventuates from the current situation between China and USA, if nothing else it shows that those interacting in global markets and in international trade need to be adaptable and flexible.

The implementation of the China Australia Free Trade Agreement (ChATA) in 2015 cemented further growth in this already-strong market. Wine exports to China from Australia have grown from \$73 million in 2008 to \$846 million in 2017 (Wine Australia, 2018). Under the ChATA, the tariffs of 14 to 20 per cent on Australian wine are due to be eliminated by 1 January 2019 (Wine Australia, 2018). Additionally, tariffs of up to 65 per cent on other alcohols are also being eliminated by 1 January 2019.

The macroeconomic factors of the value chain are currently in favour of Australian wine, mainly because of the ChATA. However, as already stated, firms should not become comfortable with favourable conditions. It is imperative that firms track macroeconomic factors and have contingency planning within network design decisions to accommodate changes in conditions. Additionally, forward planning and thought needs to be given to how the competitive landscape of the Chinese wine market could change if China enters into more free trade agreements with other countries.

International business can be volatile and firms should not take existing successes for granted and become complacent with regards to network decisions or cost structures. The macroeconomic factors of value chains will influence the success or failure of the value chain network. For wine exports specifically from Australia to China and the associated value chain, consideration of macroeconomic factors will only become more important as China continues to liberalise and open its borders for international business.

Distribution

China is made up of 23 different provinces and 11 different municipalities. There are four key municipalities that are important for wine distribution planning: Beijing, Tianjin, Shanghai and Chongqing. Shanghai and Beijing are the two largest markets for Western foods and most of the major hotels and restaurants are also located in these two municipalities. Accordingly, Shanghai and Beijing have the highest consumption rates of wine, as wine is historically a Western commodity. Wine consumption is growing in the other two municipalities, Tianjin and Chongqing, but wine consumption in rural areas is not prevalent. Hu et al. (2004) note that a significant share of imported wines into China is currently consumed in upscale restaurants in Shanghai and Beijing. However, both Lee et al. (2009) and Hu et al. (2004) conclude that consumption of wine overall is increasing across all of China.

Restaurants are the most widely used distribution channel currently for wine. Restaurants can be a difficult market to penetrate for a number of reasons. Firstly, restaurants tend to have only well-known brands or, if they do stock boutique wine, they tend to be premium boutique wines only. This creates difficulty for wines in the low-to-mid-range market to access the relevant market. Secondly, restaurants have crafted wine lists which may tailor niche and specialty wines to a certain type of cuisine or style of dining. Thirdly, restaurants generally do not have the high-level turnover of stock that characterises supermarkets.

Both Lee et al. (2009) and Hu et al. (2004) conclude that, as supermarket shopping grows across China, supermarket shelves are devoting more space to wine and wine purchases are growing in supermarkets across China. This opens a new distribution channel previously not used, or otherwise under-utilised, meaning that producers have more opportunity to enter different markets and reach different consumers.

Supermarkets are ideal for generic styles of wine and for lower price points. Supermarkets can also provide an opportunity for higher turnover of stock. The supermarket option is important for imported wine to offset high costs associated with transportation, certification and the like. Additionally, Lee et al. (2009) note that wine imported into China almost exclusively goes through distribution agents who are typically responsible for all in-country activities from port to consumer, and this adds yet another cost. Therefore, the growth of the supermarket distribution channel is positive for Australian wine.

Positive externalities

A group of positive externalities occur when the proximity of multiple firms benefits all of them. Positive externalities will occur when competitors locate to be closer to each other to create

convenience for consumers. An example in the wine business in Australia is the South Australian wine region of McLaren Vale. This region provides positive externalities among firms in a number of different ways. Firstly, the region has gained a positive reputation for producing premium wine, which provides value across the region and chain, from grape production to winery-bottled products. Firms are likely to get a better return on their investment purely by location because of this. Secondly, the region has many cellar doors (which act as a point of sale) located in close proximity to each other, so that when consumers travel to the region they have the convenience and flexibility to visit many different cellar doors and many of these benefit from increased traffic. Of course, the negatives may be that there is increased competition among firms and firms may have to rely on each other to maintain reputation. However, McLaren Vale, as an example, has only grown in popularity and value, so the positives clearly outweigh the negatives thus far.

As wine culture grows in China, so does the frequency of wine-related fairs, trade shows, wine tasting events and festivals (Bo Liu et al., 2014), all of which create an opportunity for firms to create positive externalities among firms. However, such opportunities are limited to top-tier firms because trade shows are typically expensive to participate in. Chinese tourism to Australia could also potentially create value through positive externalities between firms. If a tourist is travelling to a wine region, they have the convenience of being able to visit many different wine businesses.

Branding

Branding is an attribute external to the wine itself. It is used to differentiate a wine from others and, hopefully, to persuade the consumer to make a wine choice in favour of that particular wine. Consumers with little or no wine knowledge are expected to rely on branding for purchases (Lockshin and Rhodus, 1993). Chinese consumers, in general, have a high level of brand awareness and, importantly, brand awareness for foreign brands is typically higher than that for local brands (Kurt Salmon Associates, 2004). However, for consumers who need to make a decision on which wine to purchase but have not heard of any of the wine labels presented in the supermarket or restaurant, Jacoby et al. (1971) state that, in this decision, country-of-origin plays the most crucial factor.

Country-of-origin to consumers can denote an overall view of a product from a particular country. Consumers then make the choice based on a country's reputation in that category. Country-of-origin plays the most important role in consumer wine choices in China according to Hu et al. (2008). In fact, country-of-origin plays a big role in consumer choices of wine across the world. Wine choices are commonly made based on region- and country-of-origin. It is perceived by consumers that particular sensitivities, such as location, can influence the quality of the finished wine and certain countries or regions are well known for good quality wine. Regions whose location prominently influences consumer choice include: Bordeaux, France; Adelaide, South Australia; Verona, Italy; Porto, Portugal; Mendoza, Argentina; Bilbao, Spain; and Casablanca Valley, Chile. These names were taken from the Great Wine Capitals Global Network, which is an exclusive network of prestigious wine regions across the world. Country-of-origin is a positive, specifically for the wine market, because this market tends to be saturated with so many consumer choices – country, variety, brand, age and alcohol percentage - all of which are competing for cognitive attention.

Even more importance is placed on country-of-origin when tapping into the gift-giving culture in China. When a consumer is evaluating different options of wine as a gift, because of the perceived pressure of picking a quality bottle, consumers are more likely to consider the different characteristics of a wine, and country-of-origin will play the most important role in that choice.

Marketing

Organisations are under more pressure than ever in a globalised world to respond to an increasing rate of consumer preference changes (Carvalho et al., 2012). Product and technology life cycles are getting shorter and this creates increasing competitive pressure forcing organisations to respond and change designs of products and services in line with preferences. The competitive landscape has changed to become more consumer-driven, rather than producer-driven. Customers are more demanding and they are demanding an ever-greater differentiation of products and services (Carvalho et al., 2012).

Chinese tourism presents an opportunity for Australia wine. An increased flow of Chinese visitors to Australia creates opportunities for Australian wine businesses to influence Chinese consumer tastes and trends, to then take back to China and influence their market, especially in the higher-end and premium niche market. In 2017, Australia had roughly 1 million Chinese tourists visit and this statistic has doubled since 2012.

In terms of the responsiveness of wine in the Chinese market, Australian products in China are perceived to be good quality, clean and healthy. This provides a clear advantage for Australian wine within emerging generations of more health-conscious people. Those wines that are at the higher price point can be marketed to be of luxury and grandeur. Red wine is clearly the preferred variety. Of the total value of Australian table wine exported to China, red wine accounts for 88 per cent (ABARES, 2012; Bo Liu et al., 2014). This can be attributed to three key factors (Lee et al., 2009). Firstly, there is a clear lack of knowledge about white wine within Chinese culture. Secondly, in Chinese culture the colour red is associated with luck. Thirdly, there is a perception that red wine is healthier than white. This last point is very important for Chinese consumers because the emerging middle to upper-middle class is more health conscious (Lee et al., 2009).

Major Constraints

The first constraint to the value chain is cross-cultural boundaries. China remains a country with great diversity of culture and food (Yu et al., 2009; Bo Liu et al., 2014) and this diversity could prove an impediment to firms' success in China. As Osland (1990) says, "[t]he single greatest barrier to business success is the one erected by culture". To be successful in China, Australian firms need to have an understanding of Chinese culture and, specifically, Chinese business culture (Ambler, 1995; Myers, 1987; Xing, 1995; Zhao, 1991). Wine Australia (2018) have created a database of educational tools and research for wine businesses to access to gain a better understanding of the Chinese market and on 'how to do business' in China.

The second constraint to the value chain is a lack of reliable agents and local representation. Imported wines in China are almost exclusively handled by a Chinese agent (Carvalho, et al., 2012; Hu et al., 2004; Lee et al., 2009). Additionally, according to Rozelle et al. (2006), the lack of reliable agents for the provision of in-country value add in China is a major impediment to a firm's success in penetrating the Chinese market. If Australian firms have an unreliable local provider and do not have control of the value chain, how can they possibly be resilient or, better yet, more competitive when disruptions occur? As a result, the reliance of Australian wine businesses on local agents means that there is a lack of commercial presence for Australian wine in China. This constitutes the third constraint to the value chain: the fact that Australian wine businesses are not currently operating in China means there are reduced opportunities to create positive externalities of the kind present in Australian wine regions.

Pricing is the last constraint to be identified in this paper. China does not have consistency in pricing when it comes to negotiations and this could mean that Australia's premium reputation could be devalued. Pricing of wine in China is sometimes chosen at "face value" or based on social status. This runs the risk of not accurately reflecting the grade or actual value of the wine. Moreover, this type of

pricing structure is variable, unpredictable and creates uncertainty. This can be considered a constraint of doing business in China.

Conclusion

China has been, and will continue to be, a promising wine market. The value chain in exporting wine from Australia to China is strong. This is evident in the success that Australian wine is having in the Chinese market.

However, the constraints that are identified in this paper cannot be overlooked for future success in this market. These constraints pose risks for Australian wine businesses in a volatile situation. I believe that, of the four constraints identified, the most important to address is a lack of reliable agents because of the importance placed on managing the value chain through distribution, marketing and branding. These activities are fundamental to set the foundation for consumers' perception of a business and how well a product will do in the market place. Moreover, in a saturated market like wine and especially in a country like China, where social status is important, it becomes even more integral. So I pose this question: how can an Australian wine business control the value chain when distribution, marketing and branding is trusted to local representation and the business cannot read and write Mandarin or Cantonese? This is not to ignore the benefits that can be enjoyed by local representation, such as insights into the local market, understanding of the target audience and contacts and relationships. There are a lot of resources available for wine companies, guiding an understanding of how to do business in China. However, given the prevalence of the engagement of local representation and agents, I wonder if such guides and the other resources available are actually utilised by wine companies. Moreover, are these resources adequately preparing Australian wine businesses for the Chinese market? If not, what areas do Australian businesses need to develop to feel confident in representing their own brands in China? One example is, should they be encouraged to undertake Chinese language lessons? Further empirical research could clarify this.

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