**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**

**Diploma Thesis**

# Position of the Krasnodar Region Wine Industry in the International Market

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# CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

# DIPLOMA THESIS ASSIGNMENT

Evgeniia Chekova

Economics and Management

Thesis title

**Position of the Krasnodar Region Wine Industry in the International Market**

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**Objectives of thesis**

The study is aimed at providing an analysis of the current state of the wine industry in the Krasnodar region; determining the conditions influencing the industry; analysing its position in the international wine market; defining opportunities and threats that can influence the regional industry.

**Methodology**

Methods used for theoretical research:

1) historical method allowing to describe the history of wine industry;

2) literature review allowing to compile and analyze works on the research topic;

Methods used for empirical research:

1) market analysis allowing to investigate state and structure of the international wine market;

2) statistical methods allowing to study dynamics in the wine market and industry;

3) PEST-analysis allowing to study the influence of the external factors on the wine industry;

4) SWOT-analysis allowing to conduct analysis of broader range of factors on the wine industry;

5) synthesis allowing to make conclusion based on all types of analysis.

**The proposed extent of the thesis**

60-80 pages

**Keywords**

wine, winemaking, wine industry, wine market, international market, Krasnodar region

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**Recommended information sources**

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**The Diploma Thesis Supervisor**

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**Declaration**

I declare that I have worked on my diploma thesis titled "Position of the Krasnodar Region Wine Industry in the International Market" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the diploma thesis, I declare that the thesis does not break copyrights of any their person.

In Prague on 31.03.2016 __________________________

Evgeniia Chekova

**Acknowledgement**

I would like to express my deep appreciation to my supervisor Doc. Ing. Karel Tomšík, Ph.D., for the guidance, worthy methodological advice and valuable comments he has provided me during the work on this thesis.

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# Postavení vinařského průmyslu Krasnodarského kraje na mezinárodním trhu


**Souhrn**

Diplomová práce si klade za cíl zhodnotit stav a strukturu mezinárodního trhu s vínem. Víno existuje již tisíce let a je úzce spjato s historií civilizace a následně s historií zemědělství a obchodu. Od roku 2000 trh s vínem významně vzrostl a jeho struktura je charakteristická změnami, které spočívají především v růstu produkce, zvýšené konkurenci a změnám v geografii vinného trhu, a to především v důsledku vstupu nových subjektů na mezinárodní scénu.

Ve výzkumné části se práce zaměřuje na analýzu postavení vinařského průmyslu v Krasnodarském kraji v Rusku, který se jeví jako potenciální výrobce vína a jeho vývozce. Z pohledu globálního trhu má Krasnodarský kraj sice malý, ale aktivně se rozvíjející se vinářský průmysl. V roce 2015 se vývoz vína zvýšil o pětinásobek ve srovnání s rokem 2014.

Cílem této práce je upozornit na silné stranky vinařského průmyslu v Krasnodarském kraji a příležitosti, které se zde nabízí. Diplomová práce je zaměřena i na zjištění slabých stránek a hrozeb, které je třeba překonat.

Na základě komplexní analýzy mezinárodního trhu s vínem a vinařského průmyslu v Krasnodarském kraji jsou v práci doporučena opatření, nutná pro rozvoj vinařského průmyslu, s výhledem na možnost budoucího vstupu na mezinárodní trh.



**Klíčová slova:** víno, vinařský průmysl, vinná réva, vinice, mezinárodní trh s vínem, Krasnodarský kraj, Rusko

# Position of the Krasnodar Region Wine Industry in the International Market

**Summary**

This paper aims to offer a contribution to understanding of the state and structure of the international wine market. Wine has been existing for thousands of years and is closely connected with the history of civilization and consequently with the history of agriculture and trade. Since 2000 the wine market has grew significantly and its structure is characterized by changes. The growth, increased competition, and changes in the geography of the wine market is due to the entrance of new players into the international arena.

The research is focused on the analysis of the position of the wine industry in the Krasnodar region, Russia, as a potential producer and exporter of wine in the international wine market. Krasnodar region has a small in terms of global market but actively developing winemaking industry. In 2015 its exports increased by five times in comparison with 2014. The purpose of this work is to highlight what strength and opportunities of the Krasnodar region wine industry could be developed and what weaknesses and threats should be overcame.

Based on the comprehensive analysis of the international wine market and the wine industry in the Krasnodar region, the study introduces a set of actions and conditions required for sustainable development of the industry with a perspective to enter and succeed in the international market.

**Keywords**: wine, wine industry, grape, vineyard, wine market, international wine market, development, Krasnodar region, Russia

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# 1. Introduction

Wine always has played a special role in human history and culture. Viticulture and winemaking are an integral part of agriculture, food industry and trade. In spite of this, the exact date and place of origin of wine remains unknown. There are only guesses and hypotheses based on archeological evidences about the questions where wine emerged and how it spread. However, at present no one has any doubt that wine industry is one of the main sectors of the economy of regions with climate and soil conditions suitable for the growth of grape, the single raw material needed for production of the most famous and elegant alcoholic beverage.

Until recently, mainly European countries with old traditions of winemaking were privileged to represent the wine map of the world. However, then in the international wine market so-called New World wine producers emerged offering their fresh and original ideas, bright and modern vision of winemaking. They produce a third of all wines at present. The international wine trade growth and changes in the geography of production, consumption and trade flows characterize the global wine industry. The strong economic performance of the global wine industry and access of new producers to the international market increase the potential for further favorable development of the international wine market. At present, the wine production is increasing in large importing countries such as China and Russia that have considerable potential in the wine industry.

The south part of Russia has always been a wine producing region in different stages of development. It is explained by the unique soil and climatic characteristics of the area perfectly suitable for growing grapes and making wine. Local wine industry has been an important branch of economy during all history of development of this region. At present Krasnodar region is the largest producer of grapes and wines in Russia. Vineyards of the region amount to 42% of total Russian vineyards and produces 38% of total Russian wines. At present 30 enterprises are engaged in wine production in the region. Technologies of wine production in the Krasnodar region meet international standards. The quality of products is confirmed by victories at international wine exhibitions. Among other things, winemaking presses forward related industries such as wine tourism that is in the phase of active development. Due to all these reasons, an increasing interest related to the Krasnodar region wine industry exists. In this context it is especially important to study and develop the strategically important industry in the region in order to access the international wine market. That is why the topic is important not only from a scientific and informative, but from a practical point of view. The growing grape and making wine make it possible to maximize the use of soil and climatic conditions of the region, provide higher level of employment of the local population and higher budget revenues of the region.

# 2. Objectives and Methodology

## 2.1. Objectives

The main economic and managerial goal according to the European and Japanese market philosophy is to maximize corporate wealth. Corporate wealth goes beyond the wealth of companies; it includes also the benefit of labor, local community, suppliers, creditors and government. Developing in the case of Krasnodar wine industry means improving the welfare of population of the region, creating new jobs, raising standard of living, providing high-quality wine production, increasing the tax base and budget revenues. The maximum of the wealth is reached when a firm or industry moves from domestic to global market. Thus, it is important for every company or industry to be involved in international operations.

The accumulated experience of doing business in the field of winemaking, overcoming the existing barriers preventing the entrance into the international market, and techniques of successful competition require analysis, systematization and theoretical generalizations. The investigation will help in the elaboration of recommendations for the future development of viticulture and winemaking in the Krasnodar region and in adjustment of current strategies, and will create prerequisites for the deepening of the integration process of the Krasnodar region to the international market of wines.

The need to analyze the formation and development of the wine industry in the Krasnodar region is determined by results of the current transformations in the industry and strengthening its position. All these changes require a comprehensive analysis of domestic market development trends in order to determine the share of state regulation and support for the creation of competitive advantages.

On this basis, the study of the wine industry and problems it faced as well as investigations of ways to overcome them determined the choice of the theme, the objectives, and tasks of this research.

The **research question** of the thesis is following: What are the conditions for the sustainable development of the Krasnodar region wine industry with a perspective to enter and succeed in the international market?

The **objectives** of the thesis are to provide an analysis of the current state of wine industry in the Krasnodar region; to determine the conditions influencing the industry; to analyze its position in the international wine market; to develop a set of science-based actions in creation of conditions for the industry growth and the entrance of the wine producers of the Krasnodar region into the international market.

To answer the research question and to attain the objectives, the following **tasks** are implemented:

- determination of the historical prerequisites of winemaking;
- investigation of the formation and development of the global wine industry;
- analysis of the international wine market;
- analysis of the Krasnodar region wine industry;
- examination of the state and development trends of the regional viticulture and winemaking;
- specification of the strength and opportunities of the Krasnodar region wine industry;
- specification of the needs and problems influencing the Krasnodar region wine industry;
- formulation of the recommendations aimed at the growth of the industry and transition from domestic market to the international trade phase.

The objectives and tasks determined the structure of the thesis that consists of seven chapters including introduction, objectives and methodology, three main chapters, results of research findings, conclusion and list of references. The third chapter gives a general introduction to the concept of winemaking as well as origin and historical overview of the wine industry. In the fourth chapter the formation and development of the wine industry is discussed in detail and the modern international wine market is analyzed. The fifth chapter is dedicated to analysis of the Krasnodar region wine industry. In the sixth chapter results and recommendations based on the previous chapter are given.

## 2.2. Methodology

Different qualitative and quantitative methods are used in the thesis to implement tasks and achieve goals set before the researcher. According to applied methods, the paper is divided by two parts: theoretical and empirical.

The bases of theoretical part are literature review and historical method.

**Historical method** adopted in this study permitted the researcher to trace and describe the history of wine culture, the ways of its expanding and development in accordance with the principle of establishing a linear chronological sequence of events and phenomena.

**Literature review** is used to gather relevant information to explain concepts and terms connected with the topic of the research. This method allowed the researcher to compile and analyze key aspects of significant writings on the matter of the paper. It included overviews and analyses of books, articles and reports in English and Russian languages of American, British, Russian, Australian, French, Italian and Georgian scientists, researchers and authors.

Empirical part of the research is based on such methods as statistical method, market analysis, PEST-analysis, SWOT-analysis and synthesis. All these analyses include **statistical method** of investigation allowing to analyze dynamics of the wine industry and market. For implementation of statistical method, data are derived from a variety of sources. These sources are:

- data from public sources of international statistical agencies: United Nations Databases, International Organisation of Vine and Wine, Wine Institute;
- data from public sources of national statistic agencies: Russian Federation Federal State Statistics Service, Russian Federation Federal Customs Service; Krasnodar region Federal State Statistics Service.

**Market analysis** is applied by researcher to investigate state, structure and dynamics of the international wine market. This method is divided into five analyzed categories: production, consumption, vineyard areas, export and import.

In the market analysis, internal market coverage ratio is used for evaluation of net position of countries. The index can be defined as the level of domestic production in relation to domestic consumption. To calculate internal market coverage ratio the following formula is used:

$$Internal\ Market\ Coverage\ Ratio = \frac{Domestic\ Production}{Domestic\ Consumption} * 100, \qquad (1)$$

The index classifies countries into two groups:

- net importing countries (<100%);
- net exporting countries (>100%).

For market analysis it is necessary to use a system differentiating wine products by type. According to the Harmonized Commodity Description and Coding System (Harmonized System or HS)[1] wine trade flows between exporters and importers are divided into three categories. A six digit code identifies each type of traded wine:

- code HS 220410 means sparkling wine;
- code HS 220421 is bottled still wine in containers 2 liters or less;
- code HS 220429 includes bulk wine in containers more than 2 liters.

**PEST-analysis** allows researcher to study the influence of the external environment on the wine industry in the Krasnodar region. Thus, according to the acronym PEST, political, economic, social and technological factors are analyzed.

PEST-analysis serves as a base for **SWOT-analysis**, by using of which together with external environment internal environment is analyzed. In SWOT-analysis all analyzed factors are divided according their strategic perspectives into four groups defined by SWOT acronym: strengths, weaknesses, opportunities and threats. SWOT-analysis includes investigation of impacts of internal environment to determine strengths and weaknesses of the wine industry in the Krasnodar region, as well as external opportunities and threats for future developing and overcoming.

Combination of both methods PEST-analysis and SWOT-analysis allows to find answers on research question and using **synthesis** to give recommendations and make the conclusion of the research.

[1] Source: the official website of the World Customs Organization: http://www.wcoomd.org/

# 3. Theoretical Concept of Wine Industry

## 3.1. Concept of Winemaking

*Wine* is an alcoholic beverage received as a result of fermentation of the grape juice, says Oxford Companion to Wine (Robinson, Harding, 2015, p. 817). There is a number of classifications that diverse wines by color (red, white, rosé); by sweetness (dry, off-dry, medium, sweet); by alcohol content; by age (young or old); by producing method (still or sparkling).

Wine industry is the agriculture based manufacturing sector, the potential of which is determined by the skillful use of the favorable for growing grape climatic conditions[2], as well as available technological equipment for processing of grape and making of wine, and managerial decisions.

Winemaking or viniculture is the process that encompass two main stages. Every stage includes a wide array of factors that affect the finished product, wine. The first stage, the cultivation of grape or viticulture, is characterized by terroir elements and vineyard management. Terroir means environment where plant is growing (Jonson, Robinson, 2013) and includes such factors as location, wine producing areas in both hemispheres in temperature zones between 30° and 50° latitude, where the annual temperature is between 10°C (50°F) and 20°C (68°F); climate that determines the ability to grow grapes; vintage, weather anomalies, that can selectively make or break harvest; aspect, general topography that describes what direction the vines face, the angle and height of a slope; soil, the literal meaning of the French word “terroir”, that defines topsoil, subsoil and soil nutrients (Stevenson, 2005, pp. 14-16). Vineyard management is professional skill and knowledge of growing and taking care of vines including cutting; cane training and spur training – trellising system, the manner of which guides the size, shape, and height of the plant toward

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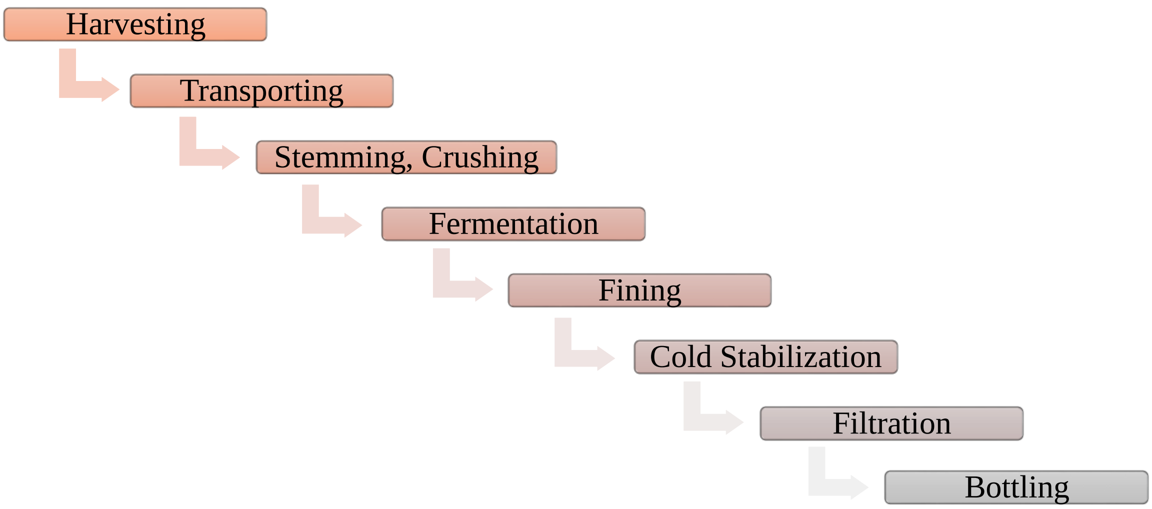
[2] **Favorable for growing grape climatic conditions** are a fine, long summer with warm, rather than hot, sunshine ensures that the grapes ripen slowly; a dry, sunny fall is essential for ripening grapes and avoiding rot; but, again, it must not be too hot; the winter months from November to February (May to August in the southern hemisphere) are climatically flexible, with the vine able to withstand temperatures as low as -4°F (-20°C) and anything other than absolute flood or drought; within the above parameters, the climate must suit the viticultural needs of specific grape varieties; for example a cooler climate for Riesling, hotter for Syrah (Stevenson, 2005, p. 15).

reaping maximum benefits from the local conditions of aspect and climate; flower and fruit formation; protection of grapes and prevention from spreading grape diseases (Jonson, Robinson, 2013; Stevenson, 2005).

The second stage, production of wine (Figure 1), is based on grape processing, the main aim of which is to extract the juice from the berries and which ranges from the harvesting (the timing of harvesting has a major influence on the wine quality, that is why this step is the most crucial decision of a grower (Stevenson, 2005, p. 22)) to transporting, stemming and crushing and vinification (Reynolds, 2010, p. 251). Elements of vinification are fermentation, the biochemical process that transforms fresh grape juice into wine; racking, draining the clear wine off its lees or sediment; fining, clarification of wine from cloudiness; cold stabilization, reducing the naturally occurring tartrates in wine by dropping to a very low temperature; filtration, prevention of particles of a certain size to pass through; and bottling, the final stage of winemaking when sterile and vacuum bottles are filled with wine (Stevenson, 2005, pp. 25-28).

Figure 1 – Winemaking Process




*Source*: Compiled by author

With new technologies, high-quality wines can be produced anywhere grapes are grown, otherwise the lack of equipment and expertise leads to producing not good wines from rich harvests. This explains that each part of viticulture and vinification works in combination with others in order to make good wines. Winemaking can be affected not only the cultivar, the region of production, but even something as trivial as the reputation of the producer that was building up over years and that can become a part of a country's or region's competitive advantage.

Wine production requires a number of the most diverse and delicate operations, so it is not surprising that winemaking has become an art since ancient times.

## 3.2. Origin of the World Wine

Wine has been existing for thousands of years and is closely connected with the history of civilization and consequently with the history of agriculture since grape, from fermentation of which the famous alcoholic beverage is produced, is considered one of the earliest cultivated fruit crops (Myles et al., 2011, p. 3530). Wine expansion resembles humans and agriculture diverse migration paths being an essential part of culture throughout history.

The history of wine has its roots in countless myths and legends of many nations. The Greeks and Romans had gods of wine, Dionysus and Bacchus. Many ancient Mediterranean cultures believed that wine sprang from blood of humans who had fought against the gods. In a Persian tale grapes in one jar stored by the king Jamsheed for a year-round fresh fruit supply, was unfortunately spoiled and mistakenly drank by someone with a headache. After the miraculous cure, the fermented grape juice was declared as a drink with medical effects (McGovern, 2007, p. 4).

Archaeology is more important and reliable resource to provide a better starting point for hypothesis about the roots and history development of viniculture than ancient texts. Using a range of scientific methods and new technologies, it can extract the maximum amount of information from archaeological remains to reconstruct ancient trade paths and economies.

There are evidences of growing grapes and making wine in all continents, where it was allowed by the climatic conditions. The archaeological records suggest that spread of viticulture or in other words domesticated cultivation of grapevine began in the Neolithic period ca. 8500–4000 B.C. in the region between the Black Sea and the Caspian Sea (Myles et al., 2011, p. 3533). Many modern interpreters of wine history claim that the earliest viniculture that encompass grapevine cultivation and winemaking emerged in the territory of Transcaucasia (modern Georgia, Armenia and Azerbaijan) during the Neolithic period dating back to around 6000 B.C. (McGovern, 2003, p. 58-59; Jonson, Robinson, 2013). This region has diverse climate and ecology with high, snow-covered mountains of the Caucasus Mountains, with more than 26,000 rivers, intermountain valleys and more than 6,000 plant species. The wild Eurasian grape (Vitis vinifera sylvestris) still thrives throughout Transcaucasia. In Georgia also the earliest evidences of winemaking in the world are found that are "based on the excavation of domesticated grape seeds, silver-encased vine cuttings, and Neolithic pottery vessels decorated with grape cluster appliqués" (McGovern et al, 2005, p. XIV). In the Georgian National Museum in Tbilisi there is an earthen vessel called "kwevri"[3] that has been dated 6000-5000 B.C.

There is also an evidence that wine was being produced on large scale in the Neolithic period ca. 5400-5000 B.C. In 1968 American archeologists from the University of Pennsylvania Museum carried out excavation at the Neolithic site of Hajji Firuz Tepe in the northern Zagros Mountains of Iran. Chemical analysis showed that found pottery jars ca. 5400 B.C. originally contained resinated wine (McGovern, 1998, p. 33). The pottery invention during that period was crucial for processing and storing fresh food, beverages, especially wine.

Being the most famous and popular alcoholic beverage, wine and its origin attracts attention of not only scientists and producers but all ordinary people and nations especially those who pretend to a right of first growers of grape and makers of wine. For this reason a huge amount of archaeological, paleontological, archaeobotanical, and even linguistical investigations were conducted.

The etymological and linguistical study by Thomas Gamkrelidze from the Georgian State University in Tbilisi and Vyacheslav Ivanov from the University of California in Los Angeles showed that the word "wine" in English "wine", Italian "vino", French "vin", derived from Latin "vinum", and in Old Irish "fín", German "Wein", Russian "vino" (with the same form in other Slavic languages) is the migratory term and has the proto-Indo-European roots from primary languages of people who had lived in Trancaucasia and in about 5,000 B.C. had started leaving the region heading toward the Near East, then Egypt

[3] **Kwevri** is a jar, which is buried underground up to the neck in the wine cellar and in which wine is fermented and stored in proper temperature (George, S. http://www.schuchmann-wines.com/assets/files/PDF/Fine_Wine_and_Liqour_Georgia.pdf).

and then Balkans bringing with yourselves culture of winemaking (Gamkrelidze, Ivanov, 1990).

The theory of the transplantation of the grapevine and wine is supported with the archaeological discovery made in the ancient Egypt city Abydos. 360 jars that originally contained wine were found in a tomb in the royal cemetery dated to ca. 3150 B.C. Chemical analysis showed that some of jars with narrow mouth suited for long-distance transportation had Palestine origin, where earlier archaeological evidence proved large-scale production of wine. This and the archaeobotanical evidence of that wild grape never grew in ancient Egypt serve as proof of the interaction and exchange of goods and even technologies in the form of pottery-making between Palestine and Egypt and the role of wine in social and political spheres as the prestige beverage of upper classes and royalty (McGovern et al, 1997). As the wine trade and the expending of viniculture had emerged, it continued to develop and spread to other main regions where civilization was forming and moving forward. The jar with the remains of wine discovered in Crete, dating from 2200 B.C., testified to the commercial and cultural ties of ancient Egypt and Crete. From Crete winemaking spread to the other islands of the Aegean Sea and the other parts of Greece. By the 2 century B.C. in Greece the winemaking industry had emerged: wine, along with olives and grain became one of the three main agricultural products in the Mediterranean region. The Greeks accustomed territories of modern Sicily, Italy, Southern France, Spain, Portugal, and Southern Russia to wine and winemaking culture (McGovern, 2007).

Once winemaking had become sustainable enterprise in the Neolithic period, wine started to be traded, market developed and the wild Eurasian grapevine was transplanted and cultivated. The wild grapevine was transferred throughout the regions now famous for winemaking, and in the result of domestication it gave birth to 99% of the world's grapevine today (Ozdemir, 2013, p. 3).

According to the wine historian, writer and journalist Rod Phillips, the spread of viticulture, winemaking and wine consumption culture is determined by four main factors. Firstly, viticulture and winemaking have been part of the exchange of information and technology between cultures. The colonialist activity was followed by the development of viticulture and winemaking. The second important impetus to the spread of wine was the fact that it had become a powerful cultural symbol in religious and in high society. In almost all cultures, wine was associated with deities and became an integral part of religious rituals.

The third factor contributing to the spread of wine was the position of wine as a profitable agricultural product. Wine became the popular traded good and acquired a vital role in the economies of many countries. In some regions of Italy, Spain and France, winemaking has become the basis for long-term economic development and prosperity. Fourth, but not less important factor was the emergence of the markets represented by wine culture (Phillips, 2002).

In the amphelographycal investigation – botanical classification of grapevine – throughout Europe, Transcaucasia, and Central Asia conducted by the Russian biologist A.M. Negrul, the scientist distinguished three main types of the wild and domesticated Eurasian grape: “occidentalis” in Central and Western Europe; “orientalis” stretching from Central Asia to Azerbaijan and Armenia; “pontica” in Eastern Europe, Turkey, Georgia and Southern Russia. “Pontica” grapevine group has larger berries, smaller and fewer seeds, lower content of acidity and sweeter taste than other types. All this makes these grapes ideal for wine production in these regions (McGovern, 2007, p. 20).

## 3.3. History of Winemaking in the Krasnodar Region

Principal wine producing area of the Russian Federation is located in the Krasnodar region, the north part of the Black Sea. The North Black Sea region is not just the main winemaking region of Russia, but also one of the oldest world wine regions.

Ancient Greek world had a great influence on the North Black Sea region. This region was the place of Greek colonization in 7000-6000 B.C. (Vinokourov, 1999, p. 7). Throughout the period of settlement, Greeks brought their culture, traditions, customs, language, art, craft and trade to the colonies.

The Bosporus Kingdom, the largest and richest ancient state of Eastern Europe in the the North Black Sea region, was founded in 500 B.C. from the Greek city-colonies (Abramov, 2007, p. 11). Major wine centers of Bosporus Kingdom were cities Phanagoria (9 wineries dating back to 1-4 centuries A.D. were investigated), Gorgippia (12 wineries dating back to 1-3 centuries A.D. were found), Hermonassa (2 winery dating back to 2-3 centuries A.D. were discovered) (Vinokourov, 1999).

The economy of the Greek colonies was agriculture, that is why they cultivated familiar to them plants in the new territories (Osborne, 1987). Considerable attention was paid to grape growing and wine production (Abramov, 2007). The spread of the grapevine depended largely on the success of grape domestification and favorable weather conditions. Therefore, winemaking and viticulture became the most important branches of the Bosporus economy along with arable farming, cattle breeding and fishing (Vinokourov, 1999). The development of viticulture and winemaking is explained by such factors as climatic, demographic (influx of population from the metropolis and barbaric world) (Abramov, 2007) and economic (increased demand for wine outside the Bosporus Kingdom) (Vinokourov, 1999).

However, the Bosporus wine and consequently wine trade had fallen into decay by the end of the 4 century A.D., which, according to the Russian archaeologist I.B. Zeest, was determined by the shortage of containers of Bosporus own making (Zeest, 1960).

The Northern Black Sea region became the part of the Russian Empire in the 18$^{th}$ century. Since that time culture and history of ancient civilizations became the heritage of the Russian society and science (Abramov, 2007).

The contemporary history of the Russian viticulture and winemaking is connected with the Czech agriculture expert Bedřich Hejduk. He became the first agronomist of the Russian Black Sea region in 1867. In reports to the head of the region Bedřich Hejduk described the north-eastern coast of the Black Sea as one of the world's best areas for cultivation of vineyards, designed by nature to produce wines of high quality (Pukish, 2015). In 1872 Bedřich Hejduk imported vines from the Western Europe. These first vines became the raw materials for wine, which laid foundation of quality winemaking in Russia. Bedřich Hejduk is considered as the father of the *Russian Wine House "Abrau Durso"*[4] and of the winemaking in the Krasnodar region.

[4] Official website of Russian Wine House "Abrau Durso": http://www.abraudurso.ru/en/house/history.

# 4. International Wine Market

## 4.1. Formation and Development of the Wine Industry and the International Wine Market

The international market is a system of commodity-money relations among countries that participate in international division of labor. The first contributions to the theory of international trade and, therefore, the promotion of goods and services in international markets were made by David Hume, Adam Smith and David Ricardo. A Scottish philosopher David Hume was the first who in his essay "Of the Balance of Trade" described an international economic model (Krugman, 2012, p. 1) and in his essay "Of the Jealousy of Trade"[5] wrote about the importance of peculiar and natural advantages for raising the commodity and exporting it and importing the commodities that other countries offer in return. Methodological basis of the nature of market mechanisms and competition and the principles of advantages were formulated and elaborated in the works of the famous British economists Adam Smith and David Ricardo (Krugman, 2012).

The world market allocates such international markets as labor, finance, gold, raw materials, machinery and equipment, food, fuel, technologies, services and others.

One of the fastest growing markets in the food area is the international wine market, since grape wine is on the 7th place in the top traded agricultural products and accounts for 2.3% of agricultural trade value according to the World Trade Organization report "Global Trade in Agriculture and Food Products" (Hamilton, 2013). The international wine market combines all the elements of the market system including manufacturing, retail, transport, customs, financial, insurance, standard and legal structures.

The significance of grape as an agricultural product and wine as a traded good is traced through the history of economic science. Adam Smith in the work "An Inquiry into the Nature and Causes of the Wealth of Nations"[6] described a well cultivated vineyard as a part of farm that could bring the most valuable produce and that such lands producing good

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[5] David Hume. Essays and Treatises on Several Subjects. Volume II, Essay VI http://www.davidhume.org/texts/etv1, p. 328.

[6] Adam Smith. An Inquiry into the Nature and Causes of the Wealth of Nations. Ch. XI "Of the Rent of Land": https://ebooks.adelaide.edu.au/s/smith/adam/s64w/complete.html.

wine can be brought into competition. David Ricardo in the work "On the Principles of Political Economy and Taxation"[7] illustrated the theory of comparative advantage using the example of Portuguese wine traded in exchange for English cloth. The theory is based on the usage by every country of its given by nature specific powers and the distribution of labor in the most effective and the most economical way so that every country could gain from trade.

Michael E. Porter, an American economist and researcher in the sphere of competition, in the essay "Clusters and the New Economics of Competition" uses the example of wine industry to demonstrate the concepts of competitive advantages and competitive success in a global economy and to explain concept of *clusters*[8] introduced by him. He describes California wine cluster, including at the moment of investigation 680 wineries; several thousand grape growers; suppliers of equipment for grape growers and wine makers; public relations and advertising firms; wine publications; institutions aimed at researches, data collecting, such as the Wine Institute; and other industries such as food and restaurants, and wine tourism (Porter, 1998, p.78).

The modern wine market is influenced by a great number of factors that have been developing during the long history of winemaking industry existence. Creation of the most recognized classic wines dates from the second half of the 17 century. This happened due to the invention of bottles for wine. The production of glass bottles was a breakthrough in wine history and trade. Before the invention of thick and sturdy wine bottles two materials were used to ferment, store and transport wine: clay and wood, but in the first half of 17 century glass bottles with corks were manufactured and the need of corkscrew emerged, that was met in the 1630s (Estreicher, 2006, pp. 73-74). In a sealed bottle wine is stored longer than in a barrel, and, moreover, is aging in the bottle acquiring a bouquet or race of wine. Before the production of bottles and corks, wines had to be consumed within a year (Simpson, 2011, p. 95). In addition, glass bottles are of particular importance for making sparkling wines. Thus, the market of quality wines appeared.

[7] David Ricardo. On the Principles of Political Economy and Taxation. Ch. VII "On Foreign Trade": http://www.econlib.org/library/Ricardo/ricP.html

[8] **Clusters** are "geographic concentrations of interconnected companies and institutions in a particular field. Clusters encompass an array of linked industries and other entities important to competition" (Porter, 1998, p. 78).

In the period of the 19th-the beginning of the 20th centuries international wine market went through many trials and underwent big changes that established modern wine industry. Trade was limited by high transport costs and taxation. Wines produced in the prerailway period mostly should be consumed locally (Simpson, 2011, p 89). Taxes distorted wine market with tariffs limiting imports of wine. Duty was usually levied by volume and consequently, as a percentage of the final price, was heaviest on cheaper wines (Franck, Johnson, Nye, 2012). Under the circumstances wine brokers appeared who looked for new markets instead of waiting for buyers to appear (Brennan, 1997). Producers in order to control sales in distant markets created brand names that exist at present time (Simpson, 2011, p. 97). The appearance of new vineyard areas with the construction of railways, improved shipping, more efficient port infrastructure, and new commercial opportunities coincided with scientific approach that began to unravel the secrets of winemaking process and develop new wines (Simpson, 2011). Then a serious shock undermined the wine market in the form of vine disease *phylloxera vastatrix* that destroyed large areas of Europe's vineyards. The solution came with the American disease-resistant roots that replaced dead vines. The appearance of new vine diseases became the reason for technological changes in viticulture. Geographical shifts were made to hot climates that was a crucial factor in the expansion of viticulture and winemaking in the New World[9] (Simpson, 2011, p. 143). The new wineries allowed to reduce labor costs, to manufacture wine on large scale, and offered great returns to producers. In reality, wine manufacturers maximized profits rather than quality, that is why economists and historians today claim that small family farmers are more efficient and highly competitive to the large estates, because they have greater incentives than wage laborers (Simpson, 2011, p. 144).

In spite of increasing the possibilities for farmers to sell in international markets creating a mass market of wine brought problems to quality of production and failures to export and threatened the status of wine as a luxury item in international trade. The addition of sugar to wine became popular and helped to improve taste of grapes in years with poor

[9] **The Old World** and **the New World** wine producers are groups of countries used by a number of authors (Anderson et al., 2001; Simpson, 2011) to describe two main wine regions of winemaking. The Old World includes France, Italy, Spain, Germany, Portugal, characterized by old traditions of winemaking. The New World refers to the United States, Australia, Argentina, South Africa, Chile, characterized by recent in comparison with the Old World wine producers emergence in the international wine market and by freedom and new ideas of winemaking.

summers. The practice of production of *piquettes* or second wines with addition of sugar with water to the remains of the grapes after first pressing became also popular; and as a result, large quantities of such wine were sold (Simpson, 2011, p. 161). The failure to develop export markets were caused by artificial or adulterated wines and copying of labels of successful brands by producers that did not have connection with the famous label regions in order to benefit from the name. The result was that sales of the strong private brand such as *Château Margaux*, *Moët&Chandon* and *Gonzalez Byass* were threatened by decline in reputation and reluctance of buyers, because large quantities of fake wines were sold under the names of the best brands (Simpson, 2011, p. 197).

The existence of the brand brokers, the medium in communication between producer and consumer, encouraged the appearance of buyer-driven commodity chains[10], where wine was bottled centrally by importers and sold under the importers' brands (Simpson, 2011, p. 192). The manipulations of merchants in the form of blending the wines and bottling centrally led to a slump in quality that generated a need of production standardization and introduction of regional appellations (local names). Appellations could better provide consumer with information about wine quality and guarantee the sales of local wines. Opponents claimed that the main purpose of appellations is to create wine provincial monopolies (Simpson, 2011, p. 241).

The French system for labeling wines was established in 1935 (Dougherty, 2012, p. 61). The categorization system includes *Appellation d'Origine Contrôlée* (AOC), the best quality wines; *Vins Délimités de Qualité Supérieure* (VDQS), the second highest classification; *Vins de Pays*, table wines from a particular region; and *Vins de Table*, table wines with identification of only grape variety used in the production of the wine (Blackburn, 2003, p. 77).

At the same time the New World increased production of wine and became less dependent on imports from the Old World. The New World wine industry developed its own style and character and had a number of advantages over the Old World producers. Grape growing was easy; vines grew fast and almost did not suffer from vine diseases; land was

[10] **Buyer-driven commodity chains** refer to labor-intensive industries, in which large retailers, brand-named merchandisers, and trading companies play the central role in setting up decentralized production networks in exporting countries (Gereffi, Korzeniewicz, 1994).

cheap; vineyards were extensively cultivated; labor costs were reduced to a minimum; investments in technologies, systems, and laboratories were made (Simpson, 2011).

In spite of appearing new production techniques, institutional innovations, business structures, until 1960s the progress was slow, and production and consumption in the industry was still culture and regional specific (Lopes, 2007). Only the major shifts in demand and consumption during next 30-40 years improved the situation and made the scientific understanding of wine industry popular (Lapsley, 1996). Thus, the modern stage of wine industry and market development dates from 1960s, when new wineries in California and Australia appeared (Jonson, Robinson, 2013).

American system for labeling wines was introduced that is based on the grape variety used for wine production (Food and Agriculture Organization agribusiness handbook, 2009). This system allows to label a wine by its grape varietal name if at least 75% of the wine consists of one particular grape (Balik, Morris, 2005, p. 27); however, to define a high-quality wine that is made using the French Bordeaux region winemaking method *Bordeaux-style* blend of grape varieties, producers are allowed to use the term *Meritage* (Food and Agriculture Organization agribusiness handbook, 2009). In American labeling system there are also categories of origin *American Viticulturally Area* (AVA), according to which winemakers may indicate a geographical feature, vineyard, or estate name (Balik, Morris, 2005, p. 27).

Progress in the transport and communications spheres favors the development of international companies. Transport costs are no longer obstacles for producers to reach consumers and to participate in the market competition. New communication systems allow establishing contacts between producers and potential consumers, which gives the opportunity to consumers to choose a product according its fair parameters in terms of price and quality.

According to the Professor of economics and Executive Director of the Wine Economics Research Centre Kym Anderson, the wine industry, international wine market and wine households have become affected by the latest wave of globalization since the 1990s. He describes globalization process by significant development of wine industry that is explained by high firms concentration in the international wine market; companies becoming multinational in terms of production and distribution; investing into foreign wineries; high rate of competition between the Old World and the New World of wines; and growing tendency to transfer international technologies (Anderson et al., 2001). The globalization brought the rapid growth of vineyard territories, quality upgrading and industry's export orientation especially in the New World that was dictated by faster growth in wine production than in consumption.

The process of integration of small wineries and large estates into international market system are offering new opportunities to develop distributional channels and elaborate marketing tools, for instance, wine-related tourism that has become a significant component of wine industry at present, because this is a way to attract potential customers and build up relationships with them.

*Wine tourism* means visiting the wineries and vineyards in wine regions or countries; this is a form of marketing and destination development, and an opportunity for direct sales and marketing on the part of the wine industry (Getz, 2000, p. 4). A British wine writer and critic Jancis Robinson explains the increasing importance of wine tourism by consumers' increased interest in wine and by privilege climatic position of wine regions (Robinson, Harding, 2015). Getz and Brown define wine tourism as a strategy for local development and the wine market in it and as an opportunity to promote sales to customers on the spot (Getz, Brown, 2006). Thus traveling to places where wine is produced is considered as market leverage that contributes to regional and local economic development.

According to the article "The Wine Distribution System over the World: an Explorative Survey" by E. Pomarici, F. Boccia, D. Catapano, evolution of commercial promotion and distribution of wine on the international market is still in progress (Pomarici et al., 2012). The authors analyze both off-trade[11] and on-trade[12] channels and show the diversity of the wine distribution patterns and actors that belong to two groups: *market makers*[13] and *matchmakers*[14], which differ in ownership flow. Both off-trade and on-trade channels are characterized by array of new typologies of outlets such as wine bars that become an alternative to traditional pubs; specialized bottle stores; wine cellars and vintners

[11] **Off-trade** channels are places where alcohol is purchased for consumption out of the place, i.e., supermarkets, wine shops (Buxton, Hughes, 2013, p. 266).
[12] **On-trade** channels are premises where alcohol is purchased and consumed on spot, i.e., pubs, cafes, restaurants, hotels (Buxton, Hughes, 2013, p. 266).
[13] **Market makers** are intermediaries who possess products – wholesalers, distributors, importers and exporters (Pomarici et al., 2012, p. 24).
[14] **Matchmakers** are intermediaries who deliver services of a negotiator – agents and brokers (Pomarici et al., 2012, p. 24).

for *connoisseurs* or experts; and retails with greater choice and easy access (Pomarici et al., 2012).

E-commerce also plays a huge role in the formation of the international markets. Removing producers can compete in the struggle for a buyer. It determines the emergence of online wine stores, place where experts with knowledge of wine industry and the wine market and internet marketing as well as share their experience and knowledge through the Internet (Pomarici et al., 2012).

Governments are actively involved in the international markets in the context of globalization. The government efforts were aimed at protection of the domestic market in order to protect national producers from the competition of foreign companies (Simpson, 2011). Despite the external relations liberalization some governments still protect certain domestic industries, although different agreements between countries and organizations such as World Trade Organization strive to diminish or abandon barriers of movement of goods and services.

The main present-day activity of the states in the foreign trade is to keep the competitiveness of the national firms at a high level. This is achieved in form of tax incentives, state lending or low official bank rates. Authorities help national companies to participate in the international exhibitions, trade fairs, competitions, and advertising campaigns. State foreign policy is also aimed at creating favorable conditions for national companies. With this purpose various treaties and agreements are signed to promote national production abroad.

Competitive rivalry in the market forces wine companies to introduce new equipment and causes scientific and technological progress, thus creating new brands of wines and improving their quality. Competition is a factor that influence the progress in the global economy, forcing companies to invest in improving technology, product quality and as a result to stimulate economic growth.

Wine industry in the structure of the international market determines the consideration of the competitiveness. However, economic science does not provide a single common interpretation of the term competitiveness. The research of M. Delgado, C. Ketels, M.E. Porter and S. Stern “The Determinants of National Competitiveness” describes evolution of competitiveness within three ideas: market share; low labor costs that could help companies to gain market share in the market; and productivity with the perspective of wealth creation (Delgado et al., 2012). M.E. Porter associates competitiveness with competitive advantage of firms that results from combination of national resources and company strategy (Porter, 1990). Competitiveness of a good can be considered as a factor of sales in the international market or the ability to retain its position in the domestic market along with import.

The main characteristics that determine the competitiveness of the wine are its price and quality and their optimal combination for the consumer. Scientific and technological advances allowed to reduce costs for production and have made quality the most important factor of competitiveness in the international market. However, because of peculiarities of the wine production, its quality depends not on the efforts of producers, but mainly on natural conditions: geographic location, soil and climate. In spite of higher price consumers choose wines of good quality.

The modern wine industry and international wine market was formed under the following circumstances:

- technological development of equipment for grape harvesting, transporting, processing and wine making that cut labor costs and made the industry less labor-intensive;
- vineyard areas expanding and using new landscapes for grape growing in result of scientific approach to viticulture;
- heavy investments made into wine business and acquisition of wine companies by foreign investors;
- wine quality improving that caused consumer loyalty to this type of beverages;
- income increase that allowed to spend more on high-quality foodstuffs including wine;
- lifestyle changes which coincided with having a meal and a rest accompanied by a ritual of moderate wine drinking;
- significance of winemaking as a part of national and regional culture and traditions of many countries;
- development of international tourism and emergence of wine tourism;
- organization of international exhibitions, auctions, presentations, competitions and wine-tastings;

- emergence of the greater number of intermediaries between producers and consumers that play different roles to meet needs and wants of every consumer;
- information and communication facility revolution and the emergence of the Internet that helped to remove boundaries among countries and between producers and consumers and made it easier to obtain information on wines and to buy them;
- basic wine education and wine brands awareness increase due to the emergence of special wine literature and magazines[15].

## 4.2. Analysis of the Modern World Wine Industry

Wine is undoubtedly a worldwide spread alcohol drink. Winemaking is traditionally connected with particular regions, namely France, Italy, Spain, Portugal, Greece, however time has changed, and new players, such as the United States, Argentina, Australia, South Africa, China, Chile, have entered the market and are fast progressing in the international arena.

According to the International Organisation of Vine and Wine (OIV) about 80 countries are engaged in production of grapes and wines. Nevertheless, only 10 countries play the role of the leading winemaking regions including France, Italy, Spain, the United States, Argentina, Australia, South Africa, China, Chile, Germany, that together account for 80% of the world wine production in 2014. In 2014 world wine production exceeded 280 million hectoliters and increased by 1.2% in comparison with 2013. Table 1 illustrates the quantitative developments for countries with production share of World Total more than 1%.

[15] *"Wine Economics and Policy"*, editor-in-chief: Silvio Menghini; *"The Journal of Wine Economics"*, editors: Kym Anderson (University of Adelaide, CEPR and World Bank), Orley Ashenfelter (Princeton University), Victor Ginsburgh (Université Libre de Bruxelles), Robert Stavins (Harvard University), Karl Storchmann (New York University); "*Wines & Vines"*, editor Jim Gordon; *"Practical Winery & Vineyard Journal"*, editor Don Neel.

<u>Table 1</u> – Wine production by country, 2011-2014, in thousand hectoliters; change by country, 2014/2013, in %

| Ranking | Country | 2011 | 2012 | 2013 | 2014 | Share of World Total, 2014 | Change in %, 2014/2013 |
|---|---|---|---|---|---|---|---|
| 1 | France | 44,322 | 50,757 | 41,075 | 46,701 | 16.54 | 13.7 |
| 2 | Italy | 46,730 | 42,705 | 54,029 | 44,739 | 15.85 | -17.2 |
| 3 | Spain | 35,353 | 33,709 | 31,233 | 38,204 | 13.53 | 22.3 |
| 4 | United States | 26,924 | 29,811 | 31,146 | 30,214 | 10.7 | -3 |
| 5 | Argentina | 15,470 | 11,778 | 14,984 | 15,197 | 5.38 | 1.4 |
| 6 | Australia | 11,090 | 11,870 | 12,500 | 12,000 | 4.25 | -4 |
| 7 | South Africa | 10,463 | 10,550 | 10,972 | 11,316 | 4.01 | 3.1 |
| 8 | China | 11,569 | 13,816 | 11,700 | 11,178 | 3.96 | -4.5 |
| 9 | Chile | 9,665 | 12,540 | 12,820 | 10,500 | 3.72 | -18.1 |
| 10 | Germany | 6,973 | 9,223 | 9,102 | 8,493 | 3.01 | -6.7 |
| 12 | Portugal | 5,610 | 6,308 | 6,308 | 6,238 | 2.21 | -1.1 |
| 11 | Russia | 6,220 | 5,720 | 5,060 | 5,130 | 1.82 | 1.4 |
| 13 | Romania | 4,058 | 3,311 | 3,310 | 5,113 | 1.81 | 54.5 |
| 14 | Greece | 2,750 | 3,115 | 3,115 | 3,343 | 1.18 | 7.3 |
| 15 | New Zeland | 2,814 | 2,690 | 2,484 | 3,204 | 1.13 | 29 |
| 16 | Hungary | 1,762 | 2,822 | 2,243 | 2,944 | 1.04 | 31.3 |
| **World Total** | | **265,438** | **276,290** | **278,854** | **282,304** | **100** | **1.2** |

*Source*: Compiled and calculated by author using data from the Wine Institute official website: http://www.wineinstitute.org/

More than half of wine production comes from four countries: France, Italy, Spain, and the United States. France, with 46,701 million hectoliters in 2014, is the world leader in wine production. French wine accounts for 16.54% of the world wine. Between 2013 and 2014 French wine production increased by 13.7%.

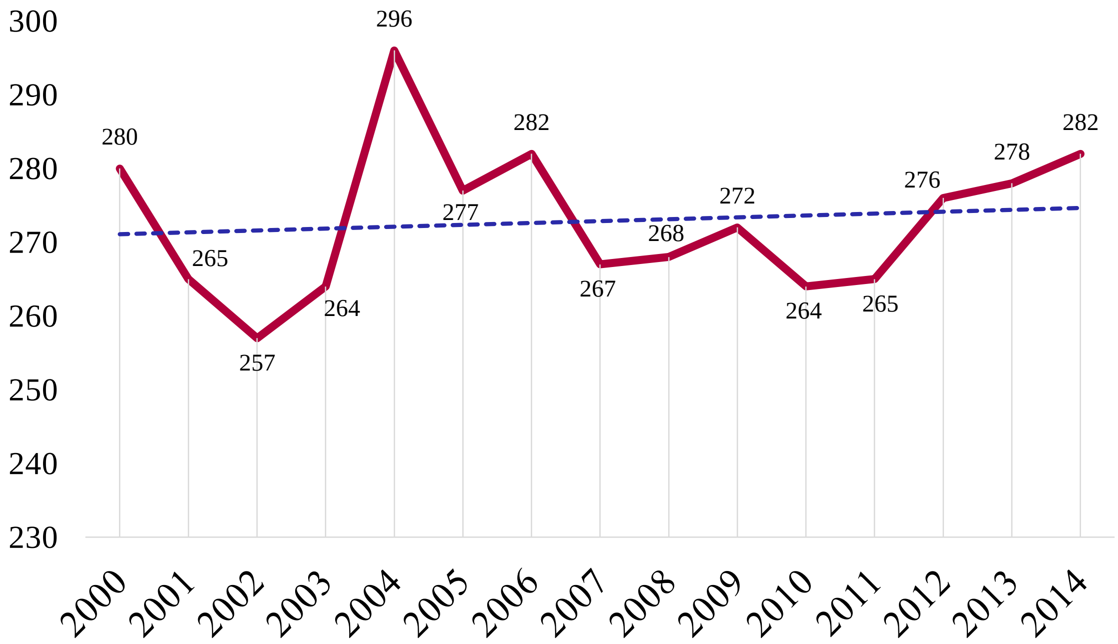
The main competitor of France, Italy in 2014 has produced 44,739 million hectoliters of wine and lost a position of leader that it had in 2013 with 54,029 million hectoliters. In comparison with 2013 Italian wine production in 2014 decreased by 17.2%.

Wine production in Spain on the contrary grew by 22.3% between 2013 and 2014 and reached 38,204 million hectoliters of wine that accounts for 13.53% of global production in 2014.

The United States with 30,214 million hectoliters of produced wine put it in fourth place of the world ranking and represents 10.7% in global production.

Comparing 2000 with 2014 the world production of wine has increased by 0.69%. Over the period 2000-2014 the maximum of wine was produced in 2004 and reached 296,390 thousand hectoliters. After the peak year, total production was steadily declining until the stabilization in 2011. The trend since 2000 is gradually but not dramatically increasing and despite falls in 2001, 2002, 2005, 2007, 2010 remains in general positive (Figure 2).

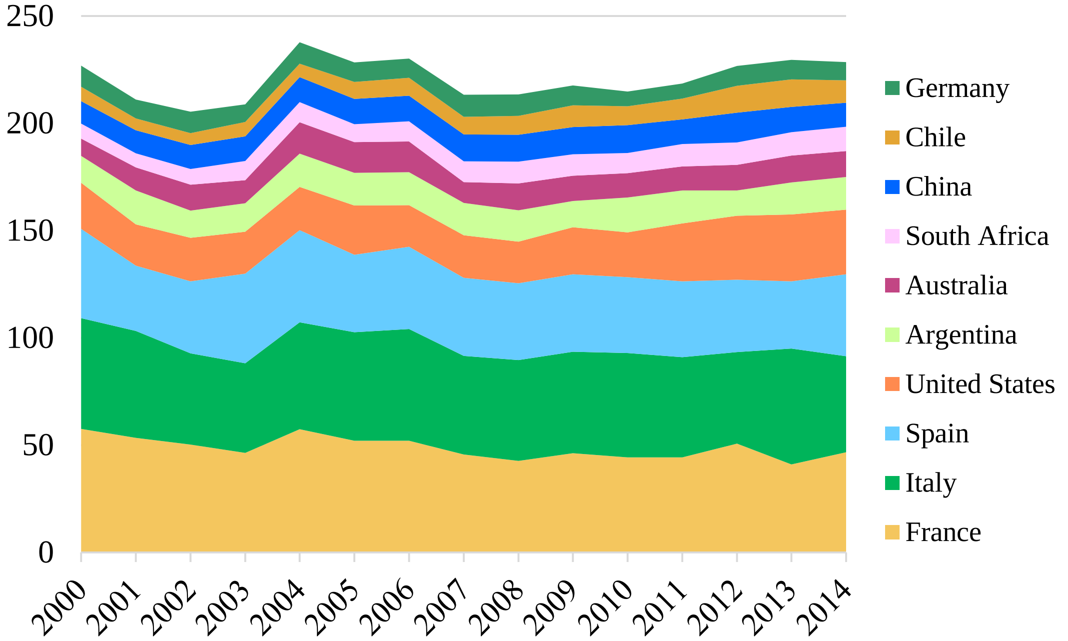
Figure 2 – Trend of world wine production, 2000-2014, in million hectoliters




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

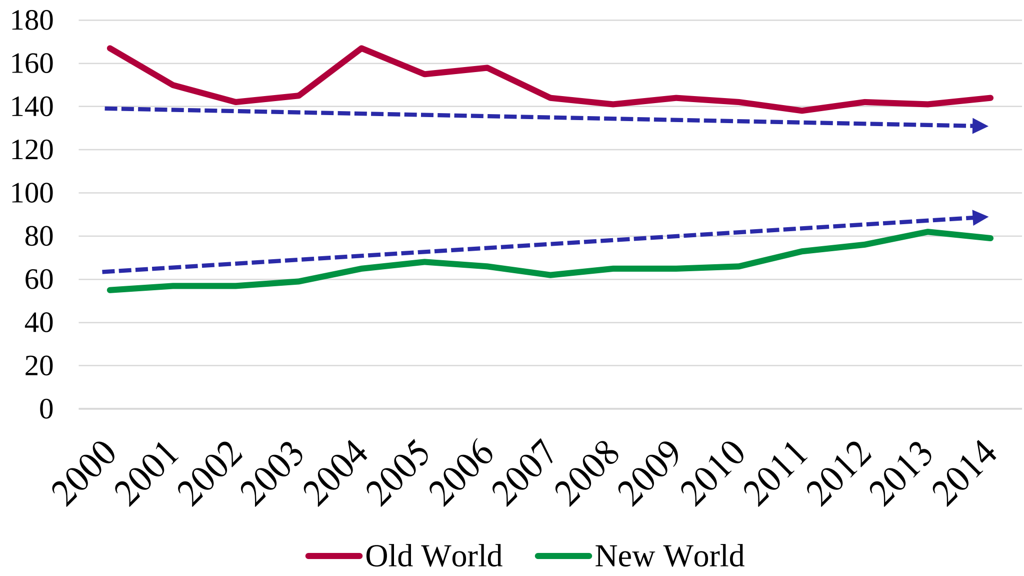
In spite of the dominance of such traditional wine countries as France, Italy and Spain (Figure 3), there is a tendency of production decline in the Old World wine countries, while the New World countries have thriving and growing wine sectors. Over the period 2000-2014 the wine production among five leaders of the Old World including France, Italy, Spain, Germany, Portugal decreased by 14%, and increased among five leaders of the New World including the United States, Argentina, Australia, South Africa, Chile increased by 42%. The trends of the Old World production decreasing and New World production increasing are represented in Figure 4.

Figure 3 – World leaders in wine production, 2000-2014, in million hectoliters




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

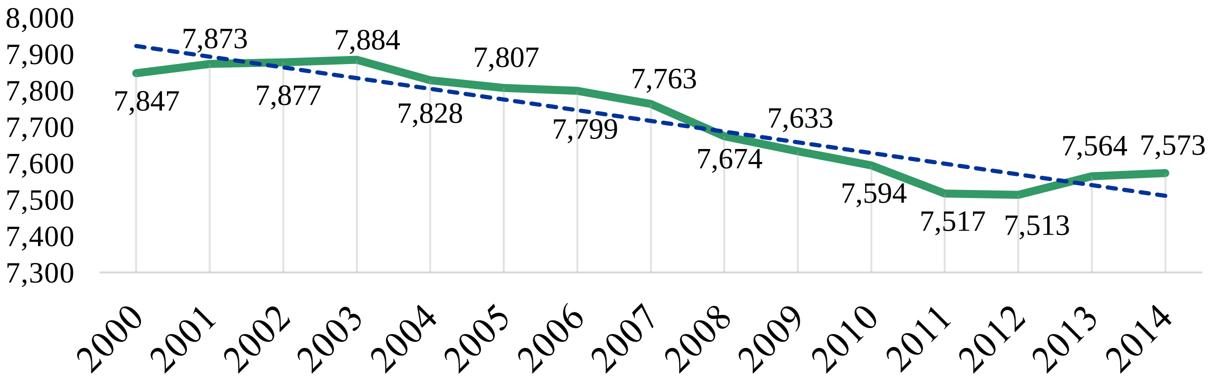
Figure 4 – Trends of wine production in the Old World wine countries and in the New World wine countries, 2000-2014, in million hectoliters




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

World surface vineyard area is 7,573 thousand hectares in 2014, that in comparison with 2000 decreased by 3.49%. According to OIV the world area under vines is has fallen considerably since 2000 (Figure 5), mainly because of reduction of European vineyards. Reduction of planted surface areas in Spain, France and Italy is influenced by *European Union grubbing-up scheme*[16], which aimed at removing vineyards producing low-quality wines and contributing to quantitative and qualitative balance in the wine market.

Figure 5 – Evolution of world vineyard area, 2000-2014, in thousand hectares




*Source*: Compiled by author using data from official website of the International Organisation of Vine and Wine: http://www.oiv.int/

In spite of the increasing competition and the steady decline of global vineyards, driven by the Old World countries, according to OIV about 40% of total area under vines is still represented by Europe and about 40% of total world grape is produced in Europe.

The prevailing trend in the modern world wine and grape situation is the change of its geography. The number of countries participated in the global market expanded. To the traditional wine regions of wine production China, the United States, Argentina, Chile, Australia have joined and have good positions in terms of all indicators characterized this type of industry, namely vineyard territories, grape and wine production, consumption.

In 2014 the world consumed 247 million hectoliters of wine. Between 2013 and 2014 world total consumption increased by 0.5% and by 9.5% between 2000 and 2014. Table 2

[16] **European Union grubbing-up scheme** is the three-year (2008-2011) premium program of reducing wine-growing areas that was implemented within the framework of the 2008 Reform of the Common Market Organisation for Wine. Over the period of the program implementing 161,164 hectares of vineyard were grubbed-up with a financial incentive from EU funds across the European Union. (European Union Working Document, 2012).

shows wine consumption figures for countries with consumption share of World Total more than 2% over the period 2011-2014.

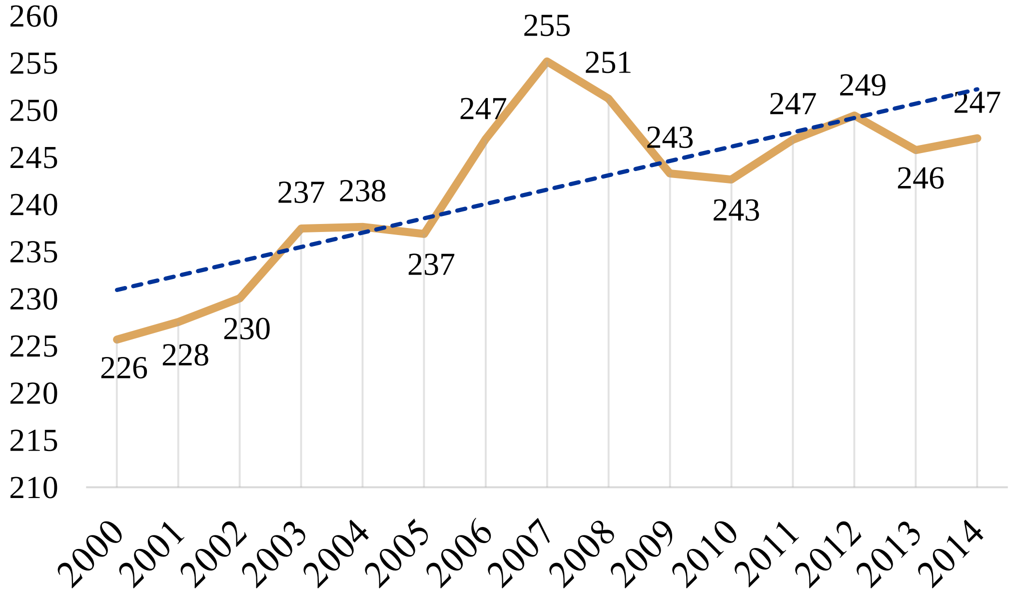
Table 2 – Wine consumption by country, 2011-2014, in thousand hectoliters; Change by country, 2014/2013, in %

| **Ranking** | **Country** | **2011** | **2012** | **2013** | **2014** | **Share of World Total, in % 2014** | **Change in %, 2014/2013** |
|---|---|---|---|---|---|---|---|
| 1 | United States | 31,633 | 31,595 | 31,176 | 32,175 | 13.03 | 3.2 |
| 2 | France | 29,322 | 30,269 | 28,181 | 27,900 | 11.29 | -1 |
| 3 | Italy | 23,052 | 22,633 | 21,795 | 20,400 | 8.26 | -6.4 |
| 4 | Germany | 19,707 | 20,000 | 20,300 | 20,200 | 8.18 | -0.49 |
| 5 | China | 15,203 | 17,737 | 17,471 | 15,800 | 6.4 | -9.56 |
| 6 | United Kingdom | 14,126 | 13,430 | 12,304 | 13,867 | 5.61 | 12.7 |
| 7 | Spain | 9,894 | 9,300 | 9,100 | 10,000 | 4.05 | 9.89 |
| 8 | Argentina | 9,809 | 10,051 | 10,337 | 9,900 | 4.01 | -4.23 |
| 9 | Russia | 11,276 | 10,394 | 10,500 | 9,600 | 3.89 | -8.57 |
| 10 | Australia | 4,620 | 4,580 | 4,530 | 5,400 | 2.19 | 19.21 |
| 11 | Romania | 3,885 | 4,369 | 5,243 | 5,300 | 2.15 | 1.09 |
| 12 | Canada | 4,700 | 4,880 | 4,980 | 5,060 | 2.05 | 1.61 |
| **World Total** | | **246,862** | **249,454** | **245,790** | **247,014** | **100** | **0.5** |

*Source*: Compiled and calculated by author using data from the Wine Institute official website: http://www.wineinstitute.org/

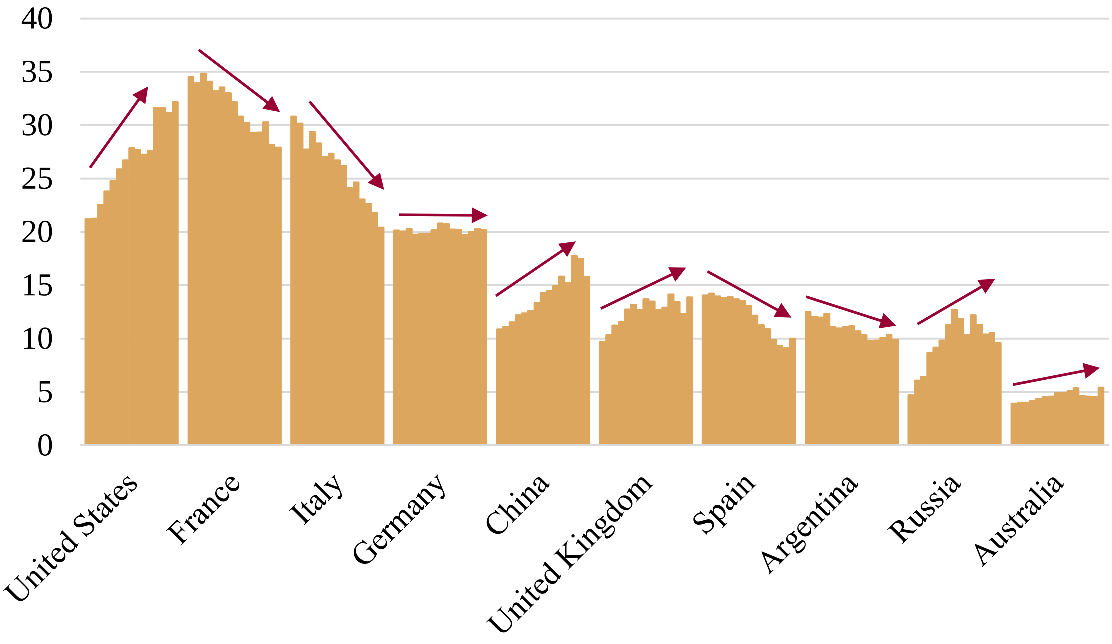
Despite the overall positive trend in global wine consumption (Figure 6), primary wine consumers demonstrate stagnant results, wine consumption in Germany increased by 0.2% between 2000 and 2014, or even declines, between 2000 and 2014 wine consumption in France decreased by 19.1%, in Italy – by 33.8%, in Spain – by 28.8%. The growth in consumption between 2000 and 2014 has primarily been driven by the United States (up by 51.8%), China (up by 45.5%), the United Kingdom (up by 43%), and Russia (up by 104.3%). The tendencies of wine consumption among the leaders in wine consumption are represented in Figure 7.

Figure 6 – Trend of world wine consumption, 2000-2014, in million hectoliters




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

Figure 7 – Trends of wine consumption by countries, 2000-2014, in million hectoliters




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

The difference between the wine production and consumption of wine over the study period (2000-2014) in on average 31.7 million hectoliters per year. Production-consumption difference allows to cover the demand for wines for industrial uses (brandy, vinegar and vermouth). According to the report "The major challenges of the vitivinicultural sector: role and strategy of the OIV" of Director General of OIV in 2014 the balance of the international wine market is assured (Aurand, 2015).

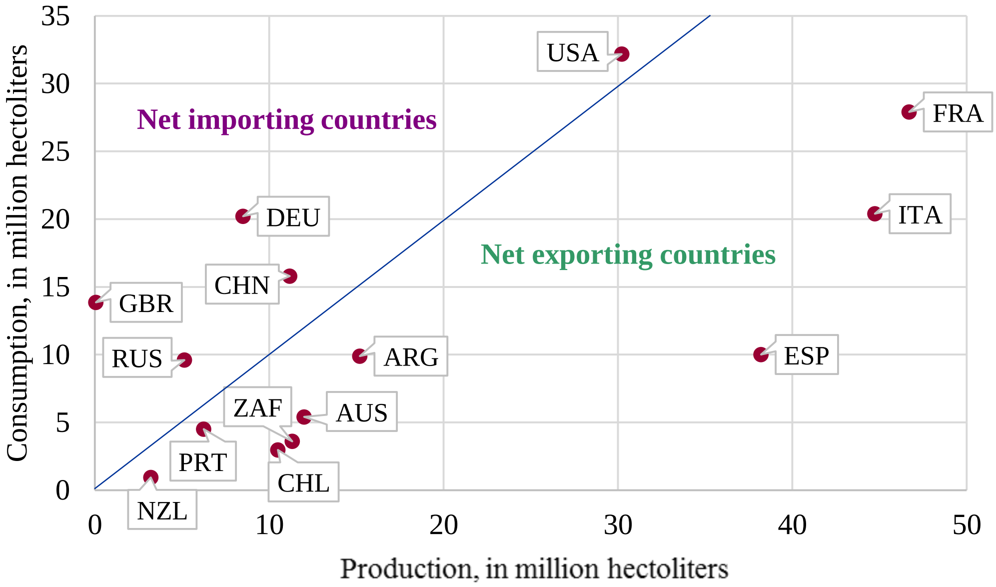
## 4.3. Analysis of the International Wine Trade

Wine has always been a traded good, but due to globalization, wine market is becoming more international and wine trade is growing steadily. If in 2000 the exported share of global wine production was 21.5%, then in 2014 36.6% of total produced wine was exported.

Considering the dominance of production or consumption in the domestic market, countries can be divided into two large groups:

1) net exporting countries;
2) net importing countries.

Figure 8 – Major net exporting and net importing countries, 2014




*Source*: Compiled by author using data from official websites of the International Organisation of Vine and Wine and the Wine Institute: http://www.oiv.int/, http://www.wineinstitute.org/

According to internal market coverage ratio, that measures the gap between these indicators, the major net exporting countries are France, Italy, Spain, Argentina, Australia, South Africa, Chile, Portugal and New Zealand (Figure 8). The list of the major net importing countries includes the United States, Germany, China, the United Kingdom and Russia (Figure 8).

The countries of the first group, domestic markets of which are reducing, are the main suppliers of wine in the international market. Downward trend in domestic consumption represented in Figure 7 in such traditional wine countries as France, Italy, Spain and Argentina that at present is considered as a part of this group, leads to the need to focus on increasing their exports.

The second group includes countries such as the United States and China, where the difference between production and consumption is decreasing every year. These two leading countries in this category differ in the degree of openness to the international market. The United States that in volume is the 2$^{nd}$ largest importer and the 7$^{th}$ largest exporter in the international wine market, has a high degree of openness. The participation of the United States wine business in the wine trade is very noticeable. For example, Californian wineries have the foreign owners from France, Italy, Japan, Australia, Spain, and the United States companies in turn purchased wineries and vineyards in other countries. The Chinese wine industry has a tendency to be independent and self-sufficient, but globalization gradually involves it in the international market.

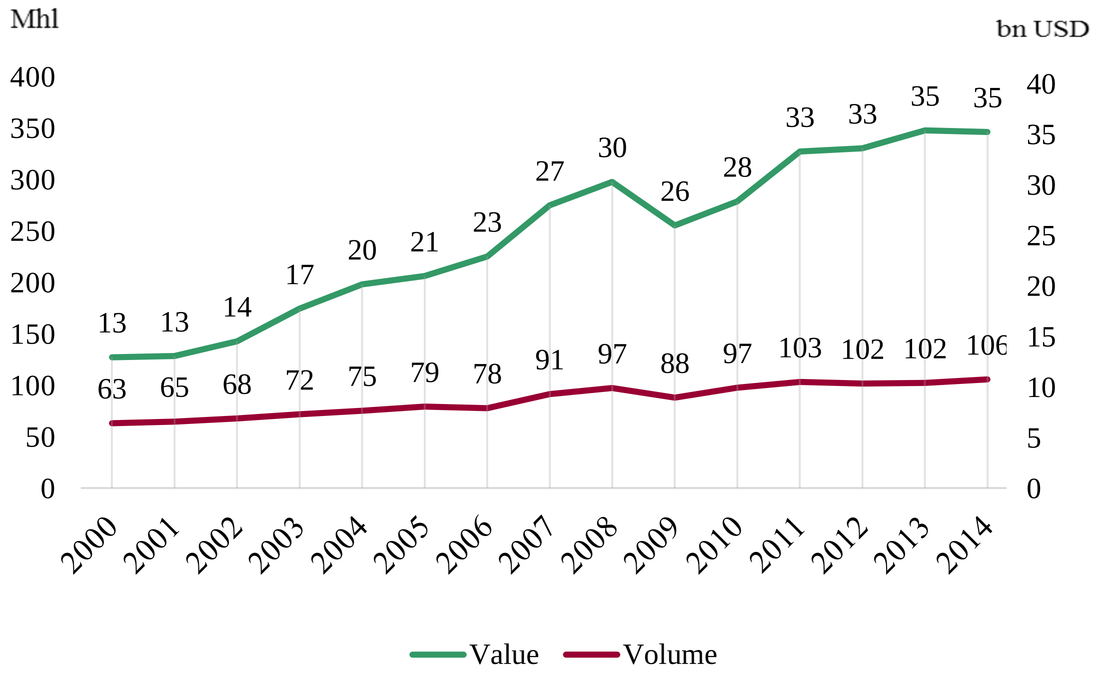
There are other divisions of countries according their role in the international market. For example, A. Mariani, E. Pomarici and V. Boatto in their article "The International Wine Trade: Recent Trends and Critical Issues" divide countries connected with wine trade into five groups:

- large importers, major destinations for wine exports (the United Kingdom, the United States and Germany);
- small traditional importers, other important destinations for wine export (Austria, Japan, Netherlands);
- small non-traditional importers, countries that have increased their wine imports (Russia, China);
- Mediterranean exporting countries (France, Italy, Spain, Portugal and Greece);

- other exporting countries with export orientation (Australia, New Zeland) (Mariani et al., 2012).

International wine trade grew significantly in the period 2000-2014, world export of wine in 2014 amounted 105.7 million hectoliters and 34.6 billion USD, that between 2000 and 2014 increased by 67.4% in volume and by 172% in value (Figure 9). In comparison with 2013 it raised by 3.5% in volume, but stayed on the same level in value. Figure 9 also illustrates decline in the wine trade in 2009 that was preceded by the economic crisis that began in the second half of 2008. Then after recovery exports reached a peak over the period 2000-2011.

Figure 9 – Evolution of wine export in volume and value, 2000-2014, in million hectoliters and billion USD




*Source*: Compiled by author using data from official website of the United Nations Comtrade Database: http://comtrade.un.org/

As it shown in Figure 10 and Figure 11 the world leading wine exporters in 2014 are Spain, France, Italy, Chile and Australia. Considering the volume indicator Spain became the leader with 24.1 million hectoliters of wine exported. France became the leader in value with 10.3 billion USD receipts.

Figure 10 – Leading countries in export, based on volume, 2014, in million hectoliters

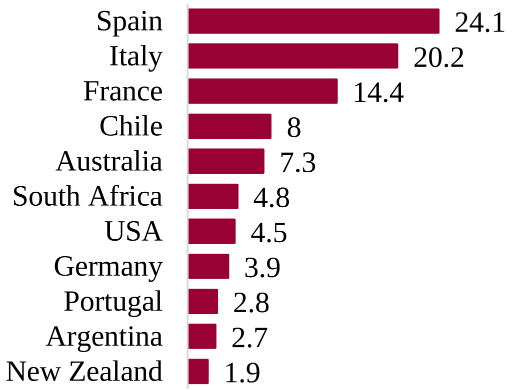
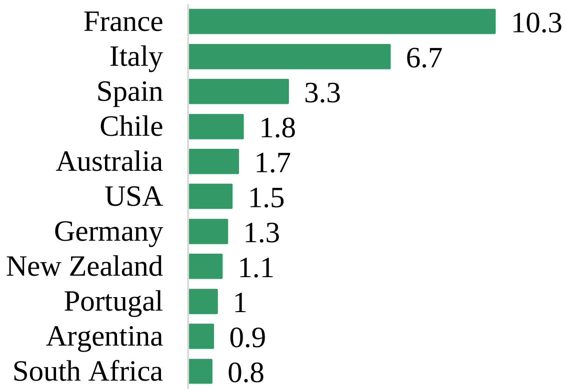



Figure 11 – Leading countries in export, based on value, 2014, in billion USD




*Source*: Figure 10 and 11 were compiled by author using data from official website of the United Nations Comtrade Database: http://comtrade.un.org/

The world leading importers of wine in 2014 are Germany, the United States, the United Kingdom, Russia and China (Figure 12 and Figure 13).

Figure 12 – Leading countries in import, based on volume, 2014, in million hectoliters

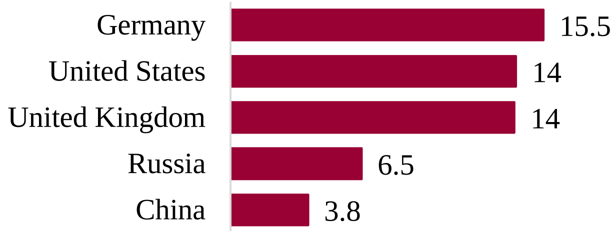
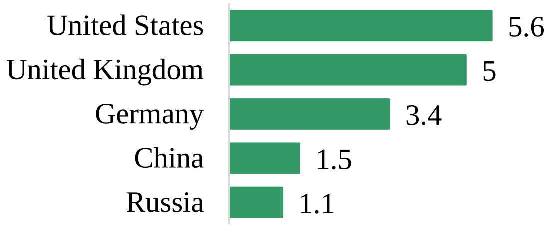



Figure 13 – Leading countries in import, based on value, 2014, in billion USD




*Source*: Figure 12 and 13 were compiled by author using data from official website of the United Nations Comtrade Database: http://comtrade.un.org/

In 2014 the country that imported wine above all countries is Germany (Figure 12). The main European supplier of wine in Germany is Italy that in 2014 exported to Germany 5.6 million hectoliters of wine. In monetary terms this amounts to 1.2 billion USD. Italy became also the main supplier of wine in Unites States and Russia in 2014. The United States spent 1.8 billion USD for 4.1 million hectoliters of Italian wine and 5.6 billion USD in total. Russia imported 0.8 million hectoliters of Italian wine and 4.7 million hectoliters in total and increased its import by 347% since 2000. China prefers French wine for 1.3 million hectoliters of which it spent 0.6 billion USD.

Many Asian countries are currently increasing the import of wines, especially China, which import in comparison with 2000 grew by more than 1000%.

The overall growth rate of wine trade is associated with raise in exports in value terms, and with the increased demand for higher-quality wines. It is clear that the increase in the wine international market at the expense of new wine regions in the future will contribute to the development of global viticulture and winemaking.

# 5. Krasnodar Region Wine Industry

## 5.1. Overview of the Krasnodar Region Wine Industry

The Krasnodar region is one of the most prosperous, investment-attractive, developed and competitive regions in the Russian Federation.

The Krasnodar region is located in the south-west of Russia. The region is included in the Southern Federal District and the North Caucasus economic region. The territory of the region is 7.6 million hectares (0.4% of the total area of Russia). The Krasnodar region is characterized by a favorable economic and geographical position and is a major transportation hub. The advantage of geographical position of Krasnodar region is connected with the fact that its territory is washed by the Azov and Black Seas from the north-west and south-west respectively. There are the popular seaside resorts in Russia. 9 ports on the Black Sea provide the Krasnodar region with direct access to international foreign trade routes to Europe, the Mediterranean, the Middle East and Central Asia.

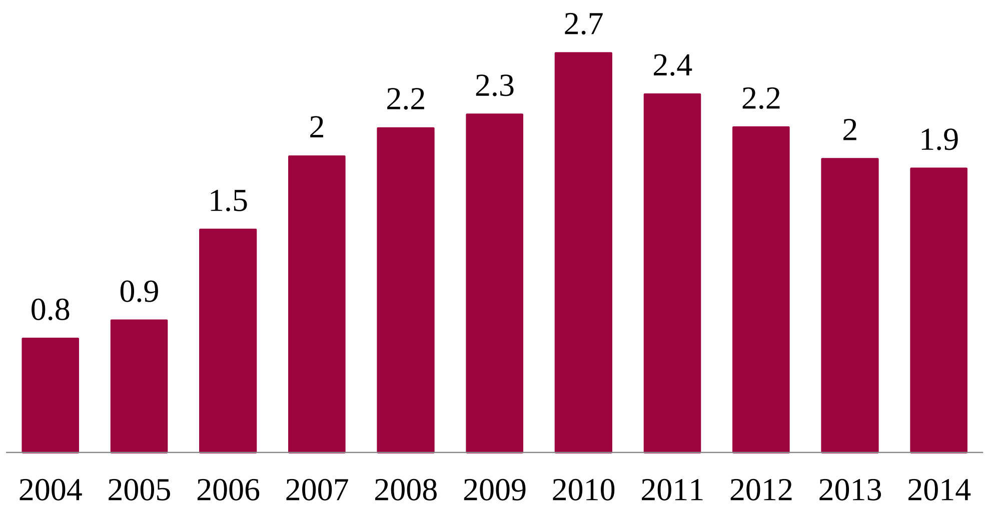
The Krasnodar region is one of the most southern regions of the country, that is why it in comparison with other regions of Russia has unique climatic conditions, which may be compared with regions of southern Europe, in particular with central France or northern Italy. The Krasnodar region has a warm and mild climate, which creates an important advantage in the development of agro-industrial activity. The territory is ideal for the development of rural economic activities, viticulture and winemaking, resort-recreational activity.

The Krasnodar region is the largest producer of grapes and wine in the Russian Federation. It is explained by the unique soil and climatic characteristics of the area, perfectly suitable for growing grapes and for the wine production. At present the vineyard area in the Krasnodar region is 27 thousand hectares that is about 42% of all vineyard plants in the country. The Russian wine economy clearly is dominated by the Krasnodar region wine industry.

In the Krasnodar region 30 wineries are engaged in wine production at present. They are located in seven sub-regions of winemaking: Novorossiysk, Krymsk, Anapa, Taman, Gelendzhik, Novokubansk, Central Kuban regions. The main grape production and processing are concentrated in the southeast part of the Krasnodar region, Anapa and Taman viticulture and winemaking areas (more than 80% of the total production of grapes and wine produced in the region).

In 2014 the region produced 1.9 million hectoliters of wine that accounts for 38% of total Russian production. The volume of wine production reached the peak in 2010 (2.7 million hectoliters). In 2014 the wine production decreased by 29% compared with 2010, but increased by 150% compared with 2004. The volume of wine production is illustrated in Figure 14. The fall is determined by the anti-counterfeiting campaigns conducted by the government and tightening rules of licensing that led to decline in production of adulteration and increased concentration of good wines in the market.

Figure 14 – Wine production in the Krasnodar region, 2004 – 2014, million of hectoliters




*Source*: Compiled by author on using data from the official website of the Krasnodar region Federal State Statistics Service: http://krsdstat.gks.ru/.

In order to increase the region's economy, to enhance the competitiveness of Krasnodar region and to become innovation-driven economy to sustain higher wages and the associated standard of living and to be able to compete with new and unique domestic and foreign products, it is necessary to evaluate the current situation and create strategies of the wine industry development.

Efficient solutions and steps, certain administrative actions and activities are needed, as well as initiatives of the business. The main idea of the development of wine industry is to switch to a new phase of the process to improve competitiveness and to create a strong microeconomic foundation of the national and global economies.

## 5.2. PEST-Analysis of the Krasnodar Region Wine Industry

The Krasnodar region wine industry has seen many changes through its history. Until 1985 viticulture and winemaking in the south of Russia had been developing in accordance with a well-rounded program. Vineyard areas in the region were brought to the maximum 64 thousand hectares, the average annual production of grapes amounted to 355 thousand tons, the production of wine accounted for 2 million hectoliters. In spite of the following recession caused by political, economic, social and technological factors, the industry has managed to survive and continues to be influenced by these factors.

### 5.2.1. Political Factors

Wine industry in Russia is regulated by the Federal Law N 171-FZ “On state regulation of production and turnover of ethyl alcohol, alcohol and products containing alcohol and on the limitation of consumption (drinking) alcohol products” and the Federal Law dated 31.12.2014 N 490-FZ “On Amendments to the Federal Law “On state regulation of production and turnover of ethyl alcohol, alcohol and products containing alcohol and on the limitation of consumption (drinking) alcohol products”.

According to the laws stated above wine production is allowed with addition of ethyl alcohol, grape distillate, wine distillate, sugar, flavors, fragrances, carbon dioxide, water. The notion wine drink is described as alcohol production that contain not less than 50% of wine must that can be produced from berries of grape or other fruit. Wines with protected geographical name have to be produced from not less than 85% of grape grown on the geographical area after name of which the wine is called, the rest of grape can be produced on the territory of the Russian Federation.

Value added tax (VAT) on wine production according the Tax Code of the Russian Federation dated 05.08.2000 N 117-FZ put into force 15 March 2016[17] depends on the type of the wine. For wines with protected geographical name (wines of higher quality) the VAT is 0.07127 USD per 1 liter (5 RUR per 1 liter), for other wines – 0.1283 USD per 1 liter (9 RUR per 1 liter). VAT on sparkling wine with protected geographical name (wines of higher quality) is 0.1853 USD per 1 liter (13 RUR per 1 liter), on other sparkling wines – 0.3706 USD per 1 liter (26 RUR per 1 liter).

The taxes structure for imported wines in the country combines 20% import duty, which is considered to be high, and 18% VAT. The import duty for bulk wine must is 5%.

On the regional level subsidies are provided under the condition of use domestic grape in accordance with the Resolution of the Governor of the Krasnodar Region dated 15 July 2014 N 679 “On provision of subsidies from the regional budget for compensation of part of planting and growing grape costs”, the Order N 11 dated 5 March 2015 “On provision of subsidies from the regional budget for support of viticulture and winemaking”, and others[18] that include subsidies for compensation of part of costs for trellis, irrigation, infrastructure systems, cultivation works, payments of interest on loans.

### 5.2.2. Economic Factors

Economic situation in Russia is reflected by political situation that has not been favorable for the country since the second half of 2014 when the Russian currency ruble fell losing about half of its value:

Exchange Rate, USD/RUB: 1 USD = 32.6587 RUR (01.01.2014); 1 USD = 56.2376 RUR (01.01.2015); 1 USD = 72.9299 RUR (01.01.2016)[19]

An interest rate peaked from 6.5% to 17% in December 2014. Since 3 August 2015 the interest rate is 11%. A weaker ruble is particularly difficult for Russian businesses. On the other hand, a weaker ruble can benefit Russian companies by making their products more

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[17] http://www.consultant.ru/document/cons_doc_LAW_28165/22201a65e4f59a582714243c15b655989bd57066/#dst100798

[18] http://vin.krasnodar.ru/activity/state_support/

[19] Data are taken from the official website of the Central Bank of the Russian Federation: http://www.cbr.ru/

competitive; for example, severe ruble depreciation caused by the 1998 currency crisis helped to generate growth after several years of contraction.

It also affects consumers, as more expensive imports have pushed inflation by 11.36 % compared to 2013 and by 12.91% in 2015 in comparison with the previous year[20]. That also affected alcohol consumption, so between 2015 and 2014 per capita consumption of still wine decreased by 3.2%, per capita consumption of sparkling wine decreased by 5.6%, and per capita consumption of spirits decreased by 7.8% (Table 3).

Table 3 – Alcohol consumption per capita in Russia, 2000-2015, in liters; change 2015/2014, in %; change 2015/2000, in %

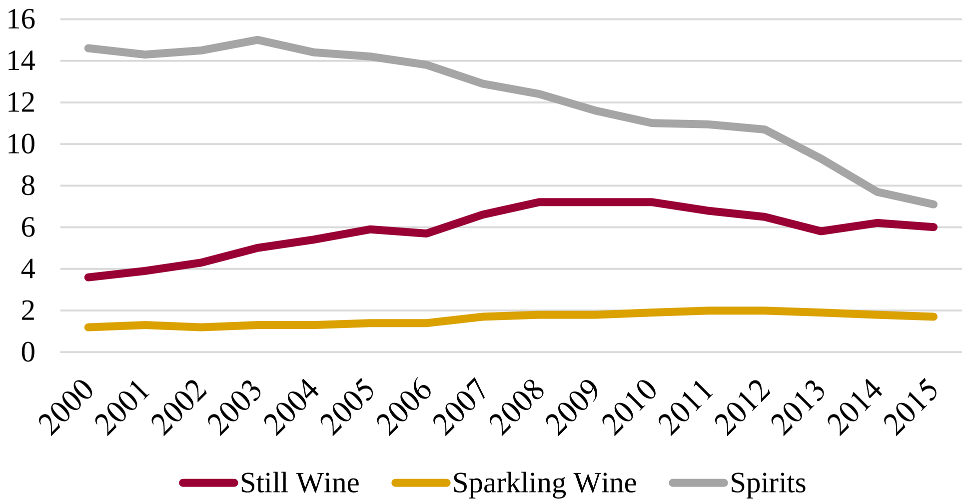
| Year | Still Wine | Sparkling Wine | Spirits |
|---|---|---|---|
| **2000** | 3.6 | 1.2 | 14.6 |
| **2001** | 3.9 | 1.3 | 14.3 |
| **2002** | 4.3 | 1.2 | 14.5 |
| **2003** | 5 | 1.3 | 15 |
| **2004** | 5.4 | 1.3 | 14.4 |
| **2005** | 5,9 | 1.4 | 14.2 |
| **2006** | 5.7 | 1.4 | 13.8 |
| **2007** | 6.6 | 1.7 | 12.9 |
| **2008** | 7.2 | 1.8 | 12.4 |
| **2009** | 7.2 | 1.8 | 11.6 |
| **2010** | 7.2 | 1.9 | 11 |
| **2011** | 6.8 | 2 | 10.9 |
| **2012** | 6.5 | 2 | 10.7 |
| **2013** | 5.8 | 1.9 | 9.3 |
| **2014** | 6.2 | 1.8 | 7.7 |
| **2015** | 6 | 1.7 | 7.1 |
| **Change in %, 2015/2014** | **-3.23** | **-5.56** | **-7.79** |
| **Change in %, 2015/2000** | **66.67** | **41.67** | **-51.37** |

*Source*: Compiled and calculated by author using data from the official website of the Russian Federation Federal State Statistics Service: http://www.gks.ru/

However, over the period 2000-1015 per capita consumption of still wine and sparkling wine has increased by 66.7% and 41.7% respectively and spirits consumption decreased more than by half. Trends of Russian alcohol consumption by type are shown in Figure 15.

[20] Data are taken from the website Worldwide Inflation Data: http://www.inflation.eu/

Figure 15 – Trends of alcohol consumption per capita in Russia, 2000-2015, in liters




*Source*: Compiled by author using data from the official website of the Russian Federation Federal State Statistics Service: http://www.gks.ru/

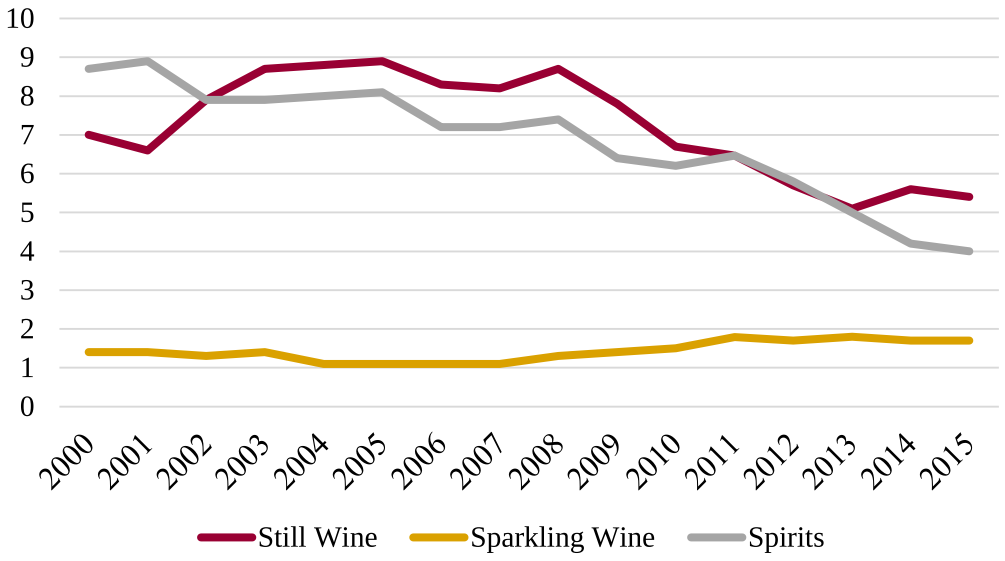
Table 4 – Alcohol consumption per capita in the Krasnodar region, 2000-2015, in liters; change 2015/2014, in %; change 2015/2000, in %

| Year | Still Wine | Sparkling Wine | Spirits |
|---|---|---|---|
| **2000** | 7 | 1.4 | 8.7 |
| **2001** | 6.6 | 1.4 | 8.9 |
| **2002** | 7.9 | 1.3 | 7.9 |
| **2003** | 8.7 | 1.4 | 7.9 |
| **2004** | 8.8 | 1.1 | 8 |
| **2005** | 8.9 | 1.1 | 8.1 |
| **2006** | 8.3 | 1.1 | 7.2 |
| **2007** | 8.2 | 1.1 | 7.2 |
| **2008** | 8.7 | 1.3 | 7.4 |
| **2009** | 7.8 | 1.4 | 6.4 |
| **2010** | 6.7 | 1.5 | 6.2 |
| **2011** | 6.5 | 1.8 | 6.5 |
| **2012** | 5.7 | 1.7 | 5.8 |
| **2013** | 5.1 | 1.8 | 5 |
| **2014** | 5.6 | 1.7 | 4.2 |
| **2015** | 5.4 | 1.7 | 4 |
| **Change in %, 2015/2014** | **-3.57** | **0** | **-4.76** |
| **Change in %, 2015/2000** | **-22.86** | **21.43** | **-54.02** |

*Source*: Compiled and calculated by author using data from the official website of the Russian Federation Federal State Statistics Service: http://www.gks.ru/

Per capita still wine consumption in the Krasnodar region shows overall negative trend, between 2015 and 2014, and 2015 and 2000 it declined by 3.6% and 22.9% respectively. Consumption of sparkling wine stayed on the same level in 2015 in comparison with 2014 and increased by 21.4% compared to 2000. As regards spirits, in 2015 people in the Krasnodar region decreased their consumption by 4.8% from 2014 and by 54% from 2000. It is noticeable that people became to drink more wine than spirits. The Krasnodar region's per capita alcohol consumption by type and trends are illustrated in Table 4 and Figure 16.

Figure 16 – Trends of alcohol consumption per capita in the Krasnodar region, 2000-2015, in liters




*Source*: Compiled by author using data from the official website of the Russian Federation Federal State Statistics Service: http://www.gks.ru/

Approximately half of wine consumed in Russia in 2014 was imported. However, according to the Russian Federation Federal State Statistics Service in 2015 import of wine declined by 30%, that was caused by depreciation of the domestic currency and decision of the Russian government to carry out a policy of import substitution and to move towards economic and production self-sufficiency.

### 5.2.3. Social Factors

The Krasnodar region is the 3rd largest region in population (5,453.3 thousand people in 2015) and the 1st agricultural region (7% of gross agriculture output) in Russia[21]. Almost half of the population is rural. About 2% of population of the Krasnodar region are engaged in viticulture and winemaking industry.

Wine industry provides jobs to a great number of people. Representatives of many professions such as grape grower, vineyard worker, winemaker or vintner, chemist, cooper, wine expert or sommelier, manager, marketing specialist, wine tour guide, wine waiter are engaged in the wine industry.

Grape is a crop that provides the largest number of jobs and gross product. One hundred hectares of vineyard create 40 jobs in the area of plant cultivation and another 20 jobs in wine production[22].

The social significance of grapes and wine as valuable food products with useful dietary and medicinal properties is explained by the long history of grape cultivation and wine production in many countries.

Wine regions became popular destinations for tourists. Always being the first sea and maintain tourism place in Russia (more than 12 million tourists in 2014), the Krasnodar region also became a wine tourism center in Russia. More than 200 thousand people visited wine estates of the region in 2014.

### 5.2.4. Technological Factors

Winemaking is art and science evolving individual creativity and technological innovations. Winemaking is also a business that is driven by manufacturing process. Modernization of this process and innovations in methods of viticulture and vinification have a direct influence on economic performance of the wine industry.

New technologies make the process of growing, harvesting, transportation, storing and production easier. The main directions of development of modern winemaking

[21] Russian Federation Federal State Statistics Service official website: http://www.gks.ru/.
[22] Krasnodar region Federal State Statistics Service official website: http://krsdstat.gks.ru/.

technology are the transition to automated in-line production processes, introduction of non-waste technology to maximize use of raw materials, fuel, electric power, which makes it possible to reduce costs.

Russia's innovation development level is not high. According to the Global Innovation Index ranking Russia is on the 48$^{th}$ place. This determines the following position in the research and development field. There are no manufactures producing high technology equipment for winemaking in Russia. That is why all technological equipment in the Krasnodar region wineries is imported.

However, as regards technology of wine production, there are two research centers in the city of Krasnodar that were established at Kuban State Technological University and Kuban State Agrarian University. The universities provide the wine industry of the region with high-qualified specialists and academic researches and services in crop and soil science, horticulture, virticulture, enology, and food science.

At present the Krasnodar region wine industry has a significant place in the Russian agriculture sector. In the past it was one of the most profitable and organized sectors of the country. Viticulture and winemaking together with the country has passed a difficult way to shift to the market economy. Demanding huge capital investments in order to recover and to become competitive in both domestic and international markets it strongly depends on support of the government and economic situation in the country and in the world. But the development and effective functioning of the market of wine is determined by the overall level of cooperation of each factor that has to any extent connection with and influence on the industry.

## 5.3. SWOT Analysis of the Krasnodar Region Wine Industry

### 5.3.1. Strengths to Build Upon

#### 5.3.1.1. Potential

The Krasnodar region is one of the leading Russian industrial viticulture and winemaking regions. It has always been considered as a wine capital of Russia. The Krasnodar region viticulture has its historical roots. People grew grapes and made wine in this region and then exported it to Greece and Egypt in the 1st century A.D. When the fertile region became a part of Russia, wine industry became a sector of primary importance. Foreign and Russian specialists in the sphere of agriculture, winemaking and chemistry were invited to develop the viniculture in the region. Czech agronomist Bedřich Hejduk revived local winemaking in 1878. Russian duke Lev Golitsyn established in 1891 commercial production of high quality sparkling wine in the winery "Abrau Durso" located in the Krasnodar region. French champagne maker Victor Dravigny came in 1905 to develop making of sparkling wine. Russian chemist and winemaker Anton Frolov-Bagreev in 1919 created a reservoir method of sparkling wine production (тем самым внес свой вклад в развитие технологии вина). The attention paid to the regional wine industry shows the significance of wine industry for the country.

The potential of wine industry depends primarily on vineyard planting and grape producing. Viticulture industry in Russia and in the Krasnodar region reached its maximum development in the 1980s (Table 5). Until 1985 the Krasnodar region viticulture and winemaking had a stage of extensive development. In 1981 the total area of vineyards amounted to 199 thousand hectares in the country and 64 thousand hectares in the region. The annual regional production of wine amounted to 2 million hectoliters of wine. In 1981 the grape yield that accounted for 79,900 hectograms per 1 hectare was higher than France had in the same year (79,501 hectograms per 1 hectare)[23].

[23] Food and Agriculture Organization of the United Nations official website: http://www.fao.org/home/en/.

Table 5 – Area of vineyards in Russia and the Krasnodar region in average,1981-2014, thousand hectares

| | 1981-1985 | 1986-1990 | 1991-1995 | 1996-2000 | 2001-2005 | 2006-2010 | 2011-2014 |
|---|---|---|---|---|---|---|---|
| Russia | 191 | 156 | 115 | 76 | 70 | 70 | 71 |
| Krasnodar region | 60 | 49 | 43 | 36 | 31 | 26 | 26 |

*Source*: Compiled and calculated by author using data from the official websites of the Russian Federation Federal State Statistics Service and the Krasnodar region Federal State Statistics Service: http://www.gks.ru/, http://krsdstat.gks.ru/.

Since 1985 a sharp decline in vineyards area has begun. In 2000 it amounted to 34.6 thousand hectares that decreased by 46% compared to 1981. In 2014 the vineyard area accounted for 26.8 thousand hectares that declined by 58%. The lowest grape yield was in 1998 with 36,000 hectograms per 1 hectare. In 2014 grape yield accounted for 97.3 hectograms per 1 hectare and allowed harvesting 191.02 thousand tons of grape and producing 1.9 million hectoliters of wine.

The numbers illustrated above show the potential existing in the Krasnodar region territories to plant minimum 64 thousand hectares and more, that is Krasnodar region has a potential in the form of the availability of land resources using of which it can increase vineyards at least by 139% in order to reach results that it had 30 years before and consequently increase production of wine.

#### 5.3.1.2. Geographical Position

The Krasnodar region has a reputation of the leader in the agro-industrial complex of Russia because of its unique natural and climatic conditions. The total land area in the region is more than 7.6 million hectares, including 3.9 million hectares of arable land. The territory is divided into five economic zones that are defined by nature and determine their specific agricultural activities. In the northern and central zones corn, sugar beet, sunflower and soybeans are cultivated; in the west zone rice is grown; the Black Sea zone is the territory for viticulture and winemaking industry; and the south zone is favorable for growing tea and citrus fruits.

Territory of the Krasnodar region is divided also into two parts by land type. The northern and central zones are characterized by plains with chernozem soil (fertile humus soil of dark color), and southern zone is characterized by mountainous surface with soil that is needed for growing grape. The soil and micro-climate characteristics contribute to the uniqueness, flavor and quality of local wines.

The region covers some climate zones from the continental to the subtropical. Moderately continental climate, high amount of average annual temperature that is approximately 280 sunny days, the influence of the sea climate, soil porosity give the possibility to produce grapes of high quality. Mild and short winters allow using not protecting from frost cultivation technology.

At present 92 grape varieties are cultivated in vineyards of the region among them there are such famous red varieties as Cabernet Sauvignon, Merlot, Pinot Franc, Saperavi, and white varieties such as Aligoté, Bianca, Chardonnay, Pinot Blanc, Rkatsiteli, Riesling.

Accounting for 42% of total Russian vineyards and producing 38% of total Russian wine the Krasnodar region proves its position of the most suitable viticulture and winemaking place in the country. It is explained by long history of cultivation of vines in the region.

Thus, the geographical location and climatic conditions of the region, the availability of fertile agricultural land have determined the position the Krasnodar region as an agricultural and industrial center and the direction of the regional economy as the powerful agro-industrial complex including wine industry.

#### 5.3.1.3. Governmental Policy

Industry development should be a part of the government strategy for increasing regional and national competitiveness. Government should be open to support all industries that show the interest for cooperation and have willingness and potential to develop.

In accordance with the "Strategy of Socio-Economic Development of the Krasnodar Region until 2020"[24] issued on the 16th of April 2008 and based on the Program of Socio-

[24] http://www.krasnodar.ru/content/38/show/49460/

Economic Development of the Russian Federation in the medium term (2006 - 2008 years), the most important sectors of the Krasnodar region economy are the agro-industrial, transport, recreational and tourism sectors. The most important direction is the development of regional strategically significant industries in order to improve the competitiveness of the priority sectors of the Krasnodar region economy. In the Krasnodar region there are several industries at different stages of the development including wine industry and tourism industry that are correlated to a certain extent.

In the framework of the "Strategy 2020" the regional government tries to maintain and develop important industries through regional infrastructure modernization in order to create favorable conditions for attracting foreign direct investments; development of forecasting, training and retraining of professional personnel; support of small and medium-sized enterprises; regional financial center generation.

According to the "Strategy 2020" the development policy of the wine industry is recognized as strategically important to ensure the long-term regional competitiveness. The inclusion of local industries in the global value chain will raise the national technological level, improve the rate and quality of economic growth by improving the international competitiveness of enterprises in the industry.

The main directions of the "Strategy 2020" are:

- development of raw material base of the wine industry, increase of vineyard area;
- investment development of wine industry, increase of investment attractiveness;
- promotion of wine produced in the Krasnodar region, in the domestic market and in the international market.

The first results were got when in 2014 the total vineyard area in the region in comparison with 2011 has increased by 1.5 thousand hectares from 25.3 thousand hectares. The Krasnodar region stopped the reduction of vineyards and renews and establishes new ones that are more fertile and could bring grape of more quality and more yield. According to the strategy it is planned to increase the vineyard area to 30 thousand hectares until 2020.

The wine industry in the region is regulated by the Department of Viticulture, Winemaking and Alcohol Industry of the Krasnodar Region, the governmental body that is responsible for licensing, budgeting, and monitoring the results of the industry.

In the region the system of subsidies is applied to refund 15% of expenditures for planting vineyards; buying technological equipment production of wine from local grapes;

research and development programs connected with breeding and cultivation of grape and with winemaking; buying or manufacturing oak barrels for aging and storing wine products; and payments of interests on loans.

The main objective of the regional and national government is to reduce imports of raw materials and wines and to increase the volume of local production.

#### 5.3.1.4. Quality

Wine quality is effected by two major processes: viticulture and vinification. The first notion is characterized by available resources that a region has for growing grape and skillful use of these resources. In subchapters Geographical Position and Governmental Policy it is explained that the Krasnodar region has suitable resources for winemaking and its government is interested in development and promotion of this industry.

The process of vilification has not less influence on the wine quality than viticulture. Being an agriculture product wine as well as the way of its producing has to be standardized.

The first step on the way to producing high quality wines was the introduction of a state standard GOST 52523-2006[25] "Table wines and table winestocks" put in force on 1 September 2008. It provided the introduction of the category "Wine of geographical name" that determines the production of wine from the local grape and bottling on the spot.

In 2012 at the meeting of the Union of Winegrowers and Winemakers of the Russian Federation[26] the following geographical names were recommended to take:

- *Kuban* (Kuban is the name of the river in the Krasnodar region),
- *Valley of the Don* (Don is the name of the river in the Rostov region),
- *Stavropol* (the Stavropol region),
- *Dagestan* (the Republic of Dagestan).

However, the Legislative Assembly of the Krasnodar region[27] has taken Kuban as the official name for wines produced from grapes grown on the territory of the region. Thus,

[25] The standard was replaced by GOST 32030-2013 put in force on 1 June 2014 and contained text amendments (http://standartgost.ru/g/ГОСТ_32030-2013).

[26] **Union of Winegrowers and Winemakers of the Russian Federation** is a non-profit association established in 2001 with the purpose to determine the policy, strategy and tactics of the state in the field of viticulture and winemaking, the wine market regulation.

[27] Krasnodar region Federal State Statistics Service official website: http://krsdstat.gks.ru/.

the geographical name of wine has became the Russian analogue of the European classifications and provides customers with the awareness on high quality wines.

This system of wine appellations helps local wine to be legally controlled by origin and to be protected from the adulteration, and to be recognized in the international market.

Quality of Kuban wines is proved by the participation and winnings in international wine fairs. The Krasnodar region producers of high quality wines have started to take part in the largest international wine exhibitions and fairs since 2011. In the London Wine Fair[28] 2011 International Wine & Spirit Competition[29], International Wine Challenge[30] the Krasnodar region wines by 10 medals and 5 certificates indicating high quality. In 2014 International Wine & Spirit Competition and International Wine Challenge marked wines of the Krasnodar region by 18 medals and 13 certificates of high quality.

An interest of people in high quality local wines and switch from other alcoholic beverages is forcing the industry to grow.

### 5.3.2. Weaknesses to Overcome

#### 5.3.2.1. Governmental Policy

The most harmful campaign for Russian and the Krasnodar region wines brought by the government was anti-alcoholic policy in 1985. Gorbachev's uprooting program (Spahni, 2000, p. 272) was the starting point of rapid reduction of vineyards that in the Krasnodar region reached 47% from 64 thousand hectares in 1981 to 34 thousand hectares in 2001.

Far more serious obstacle was that the wine industry had been deprived of governmental support. Viticulture is very unprofitable business, that is why countries that protect their wine industries provide grape growing and wine making enterprises with subsidies and financial support. It is perceived as investments in the future taxes on the final production.

The wine industry went through a severe crisis. Wineries stopped operating. Vineyard remains became less fertile. After almost half decrease of vineyard area it is

[28] http://www.londonwinefair.com/content
[29] https://www.iwsc.net/
[30] http://www.internationalwinechallenge.com/

impossible to be self-sufficient and meet the requirements in the raw materials. So the Krasnodar region winemaking is forced to struggle with the most basic problem: the shortage of raw materials. The wine industry is in high dependence on import of raw materials.

At present the government at all levels has paid its attention to agricultural business, in particular to wine industry and tries to attract entrepreneurs and their investments to viticulture and winemaking.

However, with the existing socio-economic programs presupposing that 30 thousand hectares in 2020 is enough to promote the regional wine industry in the national and international markets, the Krasnodar region winemaking will stay on the same stage of the development and even can decrease under the condition of growth in consumption.

Moreover, the governmental inefficiency is characterized by only promises, indifference in general to the industry, minimum of activities in creation of investment attractiveness of the region's wine sector, and unconcerned attitude to the formation and development of the progressive structure of wine consumption.

At present the urgent issue is connected with private ownership of land under vineyards. Most of them are in state property and rented by producers. It is associated with political and social characteristics of the country, the level of freedom and economic processes. The system of purchasing or even renting is characterized by difficult procedures. The problem with ownership directly influences the industry. The quality of the grapes are higher, if they are under the total control of the enterprise.

Governmental policy seriously affected the industry putting wine on the same level with spirits. Amendments to the federal laws[31] banned alcohol including wine advertising and tightened licensing that is accompanied by bureaucracy.

Laws on grape wine acts a long period of time in all countries producing wine, except Russia. This is a major gap in Russian legislation has caused the fact of the excessive development of wine adulteration.

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[31] Some articles of federal laws were changed in accordance with the Federal Law dated 31.12.2014 N 490-FZ "On Amendments to the Federal Law" On state regulation of production and turnover of ethyl alcohol, alcohol and products containing alcohol and on the limitation of consumption (drinking) alcohol products" and amendments dated 10.01.2015 to the Federal Law from 13.03.2006 N 38-FZ "On Advertising", allowing advertising of wine and defining wine production as food products produced as a result of fermentation of grape. (http://www.consultant.ru/document/cons_doc_law_173121/, http://www.consultant.ru/document/cons_doc_LAW_58968/)

The lack of clear requirements for the definition of the true wine concept restrains competition of producers of quality wine, since they bear higher expenditures than manufacturers of fake wine or wine drinks.

Despite the government efforts to support the wine industry, result is insignificant and sometimes is opposite to intended.

#### 5.3.2.2. Management and Marketing

Wine is highly sensitive product and hence the management at all levels on its way from vineyard to consumer is important.

A key constraint to develop the winemaking industry and extend the market is poor or inefficient management that includes vineyard management, management of the production process and marketing. Since the new period in the Krasnodar region wine industry has started comparatively recently in 2000, the business skills of managers and their management styles are needed to be improved.

The main rule is that wine quality is the main aim of a winery. But Russian mentality, accustomed and adapted to unpredictable and fast-changing political and economic environment, works in the direction of gaining quick profits and thinking about present but not future results. That is why managers decide to use old vines instead of planting new ones that would allow having higher grape yields. The other problem is using old equipment instead of purchasing new one or allocating money for research and development programs. This directly leads to a lack of domestic innovations in the industry. But such factors as production technology, blends, equipment quality, professional employees are the basis of every wine company.

The main feature of a winemaker and a winemaking manager is patience. To have capitalization growth, it is important to improve the quality of the product.

Success of wine industry includes not only making good wine but also marketing it. Such parameters as marketing, positioning, reputation, promotion and distribution are not less important. Most wine producers have to admit that the marketing tactics are the main leverages in the competition.

The Krasnodar region wine companies face difficulties with planning for the future, with taking a strategic approach, with developing different ways to reach the market and consumers, and with focusing on the long term results.

#### 5.3.2.3. Consumer Attitude

There is the other reason that prevents fast growth of the Krasnodar region wine industry. It is negative attitude of customers to local wines. People do not have information about wines of good quality or do not trust producers that try to promote their production. This is explained also by the absence of wine culture even in the wine producing region that reflects low wine consumption (wine consumption in Russia is 4.12 liters per capita).

In spite of long history of winemaking in the south of Russia wine is not a part of local traditions as it has always been for instance in France, or Italy, or Spain, and that had brought wines produced in these countries to international arena made them superb ones.

Because of different campaigns forbidding consumption of alcohol including wine, Russian people perceive wine as spirits, but not as an exquisite drink the main purpose of which is to accompany food.

The main economic factor influencing the taste and consumption of alcohol are wages. Household spending on alcoholic beverages as on any other production is higher if wages are higher. Consumers with high incomes tend to buy high quality and, consequently, more expensive domestic or foreign alcohol beverages. With increasing incomes the structure of consumption is changing and the share of wines is increasing.

For foreigners the image of Russian wines does not look attractive or they do not know about the existence of winemaking in Russia at all. The bad attitude is explained by the reputation of Soviet Union wines as very sweet wines of poor quality with use of concentrate.

Even Russian citizens do not have information that at present they can buy national wine of good quality. So the lack of the Krasnodar region wine brand is an obstacle that has to be overcome.

### 5.3.2.4. Technologies

Wine business is a high-tech industry that suppose using highly developed technologies. Such factor as the technical equipment of a winery has a great influence on future products.

In the companies of the Krasnodar region a significant part of the available equipment for processing grapes and making wine required urgent and serious renovation or replacement, as obsolete technology and high power intensity of a production run reduce economic efficiency and profitability of the industry. Businesses did not have opportunities to purchase the necessary machineries and equipment, chemicals, fertilizers due to their high prices. It resulted in the fall of productivity and production process. The deficit of material and financial resources including working capital caused the decrease of the demand for modern scientific and technological developments and new technologies.

To stay in the business the one thing was possible to produce cheap wines in large amounts. Poor quality of grape could be concealed by adding sugar, water, flavor, alcohol. In that way a concept of wine drink packaged in Tetra Pak containers appeared that had nothing in common with wine except the word wine in its name. So domestic wine lost trust of consumers together with competitiveness with imported wines and acquired a reputation of wine of poor quality.

Present situation shows that the Krasnodar region wine industry faces the lack of raw material. The problem is being resolved by importing lower cost grape and wine must. This grape as a rule does not have high-quality taste, hence wine quality suffers. Unsatisfactory conditions of Russian legal regulation requirements for quality of wine still makes possible the import of low-quality grape and wine must.

Low processing capacity as well as drawbacks of existing technologies in some companies lead to high production costs and reduce the competitiveness of products, hence consumers prefer to buy imported wine.

### 5.3.3. Opportunities to Develop

#### 5.3.3.1. Economic and Political Situation

At present Russia is actively engaged in the international trade process and takes new positions in the international market. Russian accession to the World Trade Organization in 2012[32], and retaliatory sanctions to the European Union, the United States and other countries from Russian side[33] determined new directions of Russian trade policy and domestic food security policy.

The Russian government takes measures to increase support for export of agri-food products in accordance with the rules and regulations of the World Trade Organization. The system of custom procedures has been simplified. Support is implemented for Russian exporters by partially financing the organization of Russian expositions at large international exhibitions and fairs.

Changes in political and economic situation has significantly influenced international trade between Russia and its trade partners. Imposed by Russia food embargo can become an impetus for national agricultural and industrial development.

Wines are not on the list of sanctions, but relatively high duty (20%) kept by Russia for protection of national wine producers, import value added tax (18%) and depreciation of the domestic currency almost by half since November 2014 caused slump in wine imports (Figure 17, Figure 18). Between 2014 and 2013 wine imports decreased by 7% both in volume and value. In 2015 in comparison with 2014 wine import declined by 18% in volume and 40% in value.

[32] World Trade Organization official website: https://www.wto.org/.
[33] European Union official website: http://europa.eu/.

Figure 17 – Wine import in Russia based on volume, 2013-2015, in million hectoliters

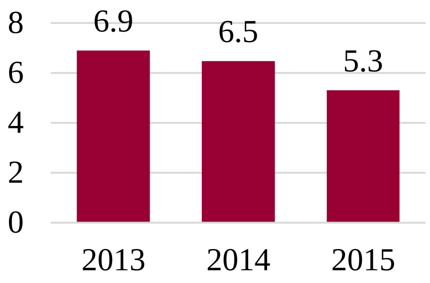
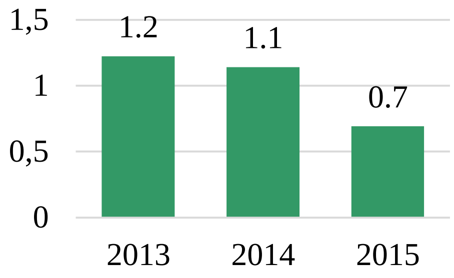



Figure 18 – Wine import in Russia, based on value, 2013-2015, in billion USD

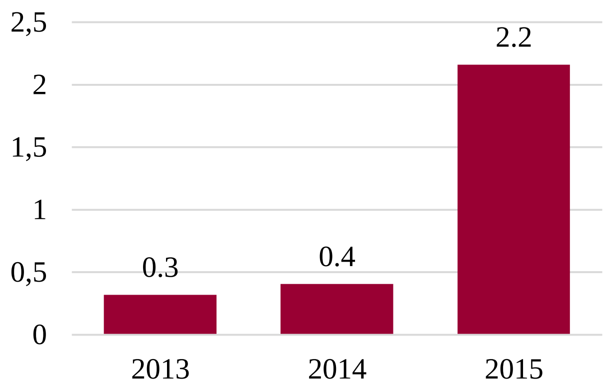



*Source*: Figure 17 and Figure 18 were compiled by author using data from the official website of the Russian Federation Federal Customs Service: http://www.customs.ru/

Strong decline of import in value could be explained by cutting prices set by exporters at least for some period in order to prevent fall in demand.

At the same time depreciated currency is able to make domestic products more attractive for export. So export of wine in the Krasnodar region was pushed up by 27% in 2014 compared with 2013, and by 5 times between 2015 and 2014 (Figure 19).

Figure 19 – Wine export in the Krasnodar region, 2013-2015, in million hectoliters




*Source*: Compiled by author using data from the official website of the Russian Federation Federal Customs Service: http://www.customs.ru/

Political situation can also become a reason of changes in consumer preferences toward domestic-made products especially if the quality of domestic production is getting better.

#### 5.3.3.2. Wine Tourism

Wine tourism is a marketing tool that can benefit both wine and recreation sectors. This is a great opportunity to attract more tourists to the region, to promote local wines, to expand customer awareness about good wines that in future can be transformed to brand loyalty, to build strong relationship of producers with customers and to bring profits. Strengthening cooperation between the wine industry and sanatorium-resort complex in the Krasnodar region will improve tourist infrastructure.

The Krasnodar region is implementing practices that are able to satisfy needs and wants of tourists and to keep them coming back.

Wine map of Kuban wine region[34] is created that gives information about 14 wine routes, 23 wineries and wine houses on the territory of the region that propose tasting and excursion services for tourists, hotels, restaurants, shops, wines, grape varieties, places to visit, events, advice. The wine map is helpful to increase people interest to local wines and to plan a trip.

At present wine tourism in the Krasnodar region at the stage of development that allow creating clusters around wineries including hotel, food and restaurant, entertainment, art, architecture and construction, transportation, infrastructure sectors. For example, wineries “Abrau Durso” and “Lefkadia” have established around themselves not just wine villages but complex projects with own unique ideas. In “Abrau Durso” village besides hotels, restaurants, wine shops, the following projects are realized and offered: spa-hotel with sparkling wine baths; art-gallery; art-park with sculptures and other art-related items; fairs with productions of the local handicrafts, different kinds of events, forums, conferences, festivals, weddings; helicopter rides with view on vineyards, the lake, hills and the Black sea; selling of real estates constructed in a common style. “Lefkadia” winery is also a part of a complex project that includes production of organic food, sanatorium-resort tourism, construction of houses with private vineyards.

Selling real estates with private vineyards or in wine regions is considered to be perspective tactics to create wine culture and a common architecture style in the region that can attract more tourists and potential buyers in the future. Moreover, Russians are interested in investing into real estate with vineyard that is proved by the Global Vineyard Index 2014

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[34] Official website of the wine map of the Krasnodar region: http://wineholidays.ru/

report. It claims that most of all requests for property abroad from Russian citizens is concerned with owning a vineyard.

As wine tourism continues to develop, the Krasnodar region wine industry will increase in popularity and gain the positive benefits derived from wine tourists.

#### 5.3.3.3. New Wine Regions Emergence

A long time in the history of winemaking only few countries had a natural privilege to produce wine. France, Italy, Spain, Portugal, Germany and Greece are among these countries. Relatively new in comparison with traditionally ones wine producing countries such as the United States, Argentina, Australia, South Africa, Chile and New Zealand at present produce more than a third of world wine and continue gradually to capture the international market.

There are many cases of regions that have opened their wine markets with great results. Among others new wine producing regions, for example, China takes the 8$^{th}$ place with more than 11 million hectoliters of wine produced in 2014 that is about 4% of total world wine production.

Thus, there is a tendency of formation and development of new wine regions in the international arena. Russia being the 11$^{th}$ in the ranking of the wine producing countries with the center of wine production in the Krasnodar region can be called a new wine region. Have created their own brand Kuban wines with slow exporting start can follow the path of newcomers to high quality wine production.

#### 5.3.3.4. Investments

The Krasnodar region wine industry has a potential to reach positive results in the international market that should be accompanied by huge investments. As a new wine region it has a great space to invest in.

A new period of the regional wine production has begun since 2000 with recovering economy in the country and with the emergence of opportunities to invest in establishing new business and reconstruction of existing ones. For such short period made investments have increased and improved wine production to such extent that local citizens can enjoy regional good wines.

At present local government is engaged in creating investment attractiveness of the region and strategically significant industries including wine industry. In this way in the "Action Plan to improve the regional investment climate and attract investments in the Krasnodar region in 2015–2017"[35] the strategic actions number 9 and number 11 are dedicated to strengthening the cooperation between wine and tourism industries and to the promotion of the local wines in the international market.

The Krasnodar region investment attractiveness is ensured by the government support and cooperation with domestic or foreign investors; good geographical location; outlet to the Black and Azov Seas; nine seaports; well-developed infrastructure; political and economic stability; existence of many investment grounds and projects.

### 5.3.4. Threats to Overcome

#### 5.3.4.1. Economic and Political Situation

A complicated and controversial economic and political situation arose for the development of Russian agro-industrial complex to ensure the food security of the country. On the one hand, Russia has a sufficient quantity of agricultural resources, not only for import substitution but also to provide the population with good quality and enough quantity food. On the other hand, there is still a technological backlog in the agricultural sector from the developed countries. This log is related to the insufficient level of innovation development of agriculture and under current condition of the international situation poses the issue of food security as the most important priority of national security.

It should be noted that the level of food consumption in Russia is achieved largely by imports. About half of food imports are food that Russia is not able to replace by its own production for objective reasons. There are products that Russia is able to produce, but anyway imports them in huge quantity, for example, wine production. In 2014 wine imports amounted to 68% of the Russian wine consumption.

[35] Investment Portal of the Krasnodar region official website: http://www.investkuban.ru/en/.

Another problem is connected with depreciated and not stable domestic currency that forces producers to bear huge losses buying foreign equipment. Higher expenditures raise prices for finished goods. That is why it is difficult to compete even with import wines as well raised in price.

Despite the high potential of agriculture sector Russia has not yet achieved the necessary volume of production, which could fully meet the population demand for certain foodstuffs produced from domestic raw materials.

The current situation shows that domestic production is not able to cover the demand of the domestic market, therefore, this demand is met by imports. In the current global crisis increases the risk of loss of foreign suppliers of raw materials and finished products, plus the instability of the external economic situation and the growth of the exchange rate increases riskiness of the activities of the industry.

#### 5.3.4.2. Consumption

Present global wine industry is characterized by underconsumption or overproduction. Production-consumption difference is increasing every year. Between 2014 and 2011 it grew by 90%. That is why an access of new wine regions such as the Krasnodar region to the international market and finding target markets can become complicated. Moreover, Russia is considered as a large importer and a change in people preferences toward local wines will push up over-supply more, but not solve the problem.

The main reason of overproduction lies in fall in wine consumption in the traditional wine producing countries France, Italy, Spain that at the same time face overcapacity and in a rise in export of wine from the New World wine countries. Argentina, Australia, South Africa, Chile and New Zealand have an export-oriented approach and treat winemaking as innovative business with a priority to issues such as the efficiency of production and marketing policy.

#### 5.3.4.3. Competition

International wine market is determined by globalization and high level of competition increased by European traditional wine producing countries France, Italy, Spain and by such countries as the United States, Argentina, Australia, South Africa, Chile and New Zealand. Old traditions of winemaking are from one side and cheap labor and innovative approaches to wine business from the other side.

The European Union is the largest wine producer in the world as well as main exporter and competitor in the wine industry. Winemaking is an integral part of life, culture and history in France, Italy, Spain and Portugal.

In the New World wine countries significant competitive advantages are achieved through mergers and acquisitions of large wine companies who are seeking to expand their portfolio and reduce the cost of distribution. In addition, there are extensive opportunities for the development of viticulture, while in many European countries, the expansion of vineyards was prohibited by law.

With a high market consolidation New World producers are seeking to have full control over the promotion of the product from producer to consumer. Acquiring related businesses such as packaging, bottling, logistics, wine shops, companies create a stable production and marketing optimization system. Consequently, minimization of the production costs per unit takes action that leads to possibility to offer a product at a lower price without losing quality. Large international companies in order to gain access to new distribution channels use the strategy of buying an existing store chain.

Thus, considering the increasing role of large wine companies, the position of local producers remains extremely fragmented, expressed by a number of small wineries, for whom it is difficult to withstand the global wine industry giants.

#### 5.3.4.4. Climate Changes

Grape is a crop that is directly exposed to risks associated with climate and weather. Therefore, grape harvests vary from year to year, and naturally from one region to another, depending on the sun and rain effects in addition to other factors. Winemaking as all agricultural sectors is highly dependent upon and interconnected with climate and weather.

Any shift or change in weather and climate, whether it is seasonal or enduring, may potentially affect the wine industry. It can spoil and reduce harvests, change taste of wine, or even make the region for grape growing less suitable than it used to be.

In addition, climate and weather changes lead to higher costs. Winemakers are forced to use irrigation systems, different techniques to cool berries, to shelter them from the sun or from frost, to change location of the vineyard rows. There are more radical methods as breeding of new varieties or cultivation of vines from other areas. Climate change can lead to adding sugar or acid to wine vinification.

## 6. Results of Research Findings

Russia even with the current level of development of viticulture and winemaking is among the leading 15 countries for the production of wine in the world. There are high-quality wines that produced from domestic grapes, but the Russian consumer does not have enough information about them and therefore is not ready yet to replace imports with good local wines. In 2014 local wines constituted only 32% of Russian wine market that makes the country import dependent. Unfortunately, this is a lost opportunity of the south of Russia, which is given to other wine producing countries.

Due to the necessity of development of domestic wine industry the main task at the present stage is reconstruction of the vineyard areas to the level of the 1980s. Only last decade some producers have started restoring the vineyards, buying new vines and manufacturing equipment. There are terroirs in Russia suitable for producing quality wine, namely terroirs of the Krasnodar region. Wines made from the grapes grown in this terroir have the right to represent domestic products in the international market.

As a positive point of state regulation, it should be noticed that national and regional authorities devise programs on support and development of domestic viticulture and winemaking industry. The Krasnodar region became the center of wine industry in Russia, producing about 40% of national wines.

The government subsidizes 15% of the costs for planting vineyards; buying technological equipment production of wine from local grapes; research and development programs connected with breeding and cultivation of grape and with winemaking; buying or manufacturing oak barrels for aging and storing wine products; and payments of interests on loans. However, these measures are not enough at this stage of development of domestic winemaking. It is necessary to increase the size of government subsidies on planting new vineyards, to simplify a system of purchasing or renting land under vineyards, and to improve laws connected with wine producing. It is necessary to establish a ban on the use concentrates, colors, flavors in wine production that will undoubtedly stimulate the viticulture and production of natural wines.

The majority of domestic wines are produced from cheap imported grapes or wine must. The share of Russian premium wines is very small.

However, the wine industry of new high level is actively being formed in the Krasnodar region at present. It is important to note that the future of the Russian wine is connected with premium wines, which bear the imprint of the terrain, the land and climate, where grapes for producing these wines were grown.

Winemaking is a strategically significant industry in the Krasnodar region economy. Large agro-industrial private enterprises were set up in the Krasnodar region in recent years. Large areas of vineyards were updated with new vines and grape varieties. Old worn-out equipment was replaced by the modern one. Viticulture and winemaking can have high profitability under the conditions of investing and applying of advanced technologies.

In order the Krasnodar region winemaking could meet modern requirements and wants of consumers, it is necessary:

- to produce more wine from local raw materials, which require upgrading existing vineyards and significant extending the area;
- to use modern machinery and equipment for wine-growing farms and wineries;
- to manage the wine industry as a cluster with a focus on production of high quality wine including related spheres such as research and development, education, marketing, wine tourism;
- to promote quality wine in the domestic and international markets with using producers and government cooperative efforts.

All this requires significant investments. However, every year an interest in the Kuban wines grows significantly. South of Russia has long been famous for its vineyards that was determined by unique climatic conditions. Scientists and agronomists evaluating the potential of the Black Sea lands claimed that this region is one of the world’s best areas for cultivation of vineyards. The Krasnodar region modern wines give a possibility to wine critics and world-class experts to look at Russian wines in a completely new way and to evaluate them. These wines win prizes at prestigious exhibitions.

Another aspect that has a serious impact on the development of domestic wine industry is the image of Russian wines in the eyes of consumers. The maximum profit is often gained by unfair competitors. An honest manufacturer is not able to compete with them. Among the most famous and respected companies are companies from the Krasnodar region: “Fanagoria”, “Abrau Durso”, “Kuban-vino”, “Myskhako”, “Chateau Le Grand Vostok”. These producers create an attractive image of the entire Russian winemaking and promote its progressive development.

For many consumers, domestic wine is associated with the production of low price segment and low quality. This reason of such attitude is decrease in vineyard areas, which leads to a drop in production volumes in the wine industry. There are many wine making firms, who import wine must of the lowest quality, add alcohol, sugar, coloring and flavoring agents, and their actions are not restricted by the laws, and thus, cheap products of poor quality appear in the domestic market. These firms strike a blow against the image of good local wines and consumer has no desire to buy even well-known domestic brands. These problems clog the market of local premium wines.

Rectify the situation can only competent quality control system and the creation of conditions in which to produce and sell high quality natural wines would be beneficial.

Nevertheless, the Krasnodar region wine industry is approaching the European winemaking. Producers change the philosophy of winemaking taking into account the centuries formed in the leading wine producing countries traditions. Producers should continuously improve product quality, develop marketing strategies, as well as the overall level of management and communication with customers.

Culture of wine consumption should also be actively promoted. To reach this the leading producers should conduct educational activities, excursions, tours, tastings, as well as talk about the history of winemaking, wine etiquette, try to teach people to understand quality of wines. In this regard, some wineries promote wine tourism. That is not just a trip to a farm that produces high quality wines, but a trip to the homeland of wine with its unique culture, traditions and national features.

At the same time brand creating process can have a positive impact on the structure of wine market. This will reduce the production of adulteration and the risk of consumption of low-quality products, and will enhance the competitiveness of the regional wines in the domestic and international markets.

Acquisition of customer loyalty is the basis of successful marketing policy. Brand is not just a well-known trademark. It carries certain values, offers advantages, and makes consumers loyal. The process of wine brand building begins with improving quality of products. Considerable financial and intellectual investment are needed as well for creation and promotion of the brand in the market.

The main task is to promote brand of Kuban wine and with its help to change the perception of the Russian wines from negative to positive. It is necessary to promote Kuban wine brand to the premium segment. Thus, companies who will be able to build a strong brand of wine in the domestic market, will be able to acquire recognition in the international wine market.

Currently, there is a realization of the “Strategy of Socio-Economic Development of the Krasnodar Region until 2020”, in which the agricultural sector including the wine industry is the major direction of the regional development. Creation of the strategy is caused by necessity of the elimination of the negative changes that have occurred in the Krasnodar region wine industry over the past three decades, led to a reduction in industrial vineyard areas by 58%.

The Krasnodar region wine industry can and must compete on equal terms with other regions in the field of viticulture and winemaking in the domestic and international markets. Implementation of the strategy will contribute to an increase of the production of wine and improving its quality, providing economic incentives for science and technology development of the wine industry. The strategy includes a range of government measures including subsidies for expanding the areas of vineyards by planting new, reconstruction and renovation of existing vineyards, researches in the field, breeding new grape varieties, development of efficient technologies of cultivation of grape and making of wine. The strategy is a state tool to achieve the objectives of the sustainable growth of the wine industry, production of high quality and competitive wines.

In spite of the fact that the domestic wine consumption lags behind developed countries, the Krasnodar region wine industry shows the considerable promise. Adapted to growing grapes the potential of the continental climate moderated by the Black and Azov seas, used not at full power lands and quality and cheap labor allow creating new winemaking companies and developing the existing ones. With the support of the state, the local wine production can develop rapidly and go on exports.

Creating a favorable investment climate in the region in general and in particular in the industry is a very important condition for improving the competitiveness of the local winemaking. This requires the active participation of the federal and regional authorities, efficient policy on development of the national viticulture and winemaking, and specific conditions to attract investments, in which preference should be given to investors, successfully involved in the wine business. These measures will contribute to reduction of import wines and production of good competitive wines with subsequent expansion in both domestic and international markets.

Despite the minor position of the Krasnodar region wine industry in the international market at present, it is important to highlight that according to PEST and SWOT analyses it has a potential to be internationally recognized under the conditions of overcoming all weaknesses and threats and developing all strength and opportunities.

Thus, it is necessary to take following actions:

1) coordination of activities of all market participants including related industries as well as participation of government and educational institutions. It is necessary to accumulate efforts, to bring the industry to a new stage of development and to strengthen national competitive advantage;

2) restoring raw materials infrastructure sector; allocation of federal funds to planting vineyards; control over the quality of planting material; renovation of the tradition of high-quality grape-growing farms;

3) rational use of domestic raw materials; developing agro-industrial integration between the producers of grapes and wineries;

4) increase of production and sales of domestic production in the domestic and international markets; moderate protection of domestic producers from foreign competition with using different tools from the side of the government such as custom regulations, tariffs; realization of the programs of domestic production competitiveness support;

5) establishing contacts between Russia and the former Soviet republics and other potential markets with a purpose of exporting domestic production;

6) creation of international financial and industrial groups, which have well-coordinated mechanism of wine production and implementation of investment projects;

7) improvement of the profitability of the wine industry by improving the material and technical base and the creation of new technological systems for the production of wine; increase of the share of high-quality wine production in total production;

8) renovation of the historical traditions and culture of wine drinking;

9) bringing information about advantages of the regional wines to potential customers and stimulation of their desire to purchase Kuban wines;

10) production standardization and introduction of regional appellations; production of high-quality competitive wines and branding in all segments of the market that will form the standard of consumption and protect consumers from fake brands and wines.

The Krasnodar region being an agricultural center of Russia anyway has a large unrealized agricultural and industrial potential. At present it has a chance to take advantage of its historic competitive advantage and strengthen the role of Russia in the world in both economic and political terms. This requires developing the export system and appropriating funds for realization of domestic production support. Production of agricultural goods for export remains very promising direction of development of the national and regional economies under any economic conditions.

# 7. Conclusion

Wine has been existing for about 8 centuries and has always been connected with the agricultural activity of people. The significance of grape as an agricultural product and wine as a traded good is traced also through the history of economic science.

At present wine industry and wine market are characterized by the high level of development, globalization and competition. Over the period 2000-2014 the wine trade grew significantly by 67.4%. In 2014 36.6% of total produced wine was exported, while in 2000 the exported share of global wine production accounted for 21.5%. Among the five leading (62% of world wine production) wine production countries are France, Italy and Spain, so-called the Old World wine producers as they have the ancient winemaking traditions, and the United States and Argentina, the New World wine producers. However, the share of the international wine market patterns such as production, consumption and vineyard areas of the Old World producers decreases every year due to the growth of the share of their direct competitors from the New World wine producers, the United States, Argentina, Australia, Chile and South Africa, and new potential markets such as China and Russia that are in the ranking of leading countries in wine production and consumption. Thus, the shifts in the geography of the world wine atlas and the emergence and growth of new and not famous wine producing regions illustrate the evolution of the international wine market continuous development.

Based on the analysis of different literature, articles, reports, PEST and SWOT analyses it is important to emphasize that the Krasnodar region is represented on the world wine map, but its wines are not known internationally. The Krasnodar region is a small wine producing region in a global context of general wine overproduction and high competition, but it has a potential in the form of unique climatic and soil conditions perfectly suitable for grape growing and wine making in the region; high level of manufacturing capacities the regional industry has shown in the past; production of high-quality wines that can compete equally with the world wide known wines; creation of the regional brand of quality wines with long history and reflecting traditions and values of the region and the country; support provided by the government as to the strategically significant industry; development of related industries such as tourism and food and restaurant industries; and large investment flows to the regional wineries and vineyards; breeding of new and unique grape varieties for winemaking; researches and developments of the technological process of winemaking.

However, the Krasnodar region wine industry faces some difficulties on the way of its development. The main reasons constrained the growth of the industry are governmental anti-alcohol campaigns resulted in the fierce reduction of vineyard areas in the region and deterioration of wine culture and consumption; unstable economic and political situation of the country in general that completely affected agricultural, industrial, technological and business development of the country that also resulted in the gap in the way of management and marketing; governmental regulation that with inefficient law system that complicates the process of land purchasing or renting and until recently had provoked production of adulteration wines. All these makes the Krasnodar region wines less competitive in the international wine market.

On the basis of elaboration of strengths, weaknesses, opportunities and threats influencing the Krasnodar region a set of actions in creation of conditions for the industry growth and the entrance of the wine producers of the Krasnodar region into the international market is provided.

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