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Does Organisation Matter? A Comparison of Co-operative and Ex-Co-operative Cellars in the New Era of South African Wine

Joachim Ewert and John Hanf

Since the mid-1990s the number of South African wine co-operatives has been reduced by two-thirds. Some of it is due to mergers, but others have converted to companies, partly because they are convinced that this is an organisational model superior to that of co-operatives. By converting, these cellars hoped to free themselves from the classical constraints suffered by co-operatives. But have these hopes actually been realised?

This is the central question of the paper. In trying to answer it the paper draws on case studies of 14 co-operatives and ex-co-operatives conducted between 2014-2016. The analysis relies mainly on data and information supplied by cellar staff during in-depth interviews. In our assessment we translate ‘performance’ into financial stability and for this purpose we use mainly two indicators, viz. capital ratio and cash flow.

The cases are analysed against the backdrop of co-operative theory, changes in the South African wine industry over the last 20 years, and the particular nature of South African co-operatives.

Introduction

One could argue that South Africa has gone through a true ‘revolution’ in wine quality in the last 20 years (James, 2013). Before the mid-1990s, some 71 co-operative cellars supplied most of the wine to a small number of producing wholesalers and marketers. A ‘pool’ system in co-operatives and overall regulation gave incentives on the basis of volume, rather than price, with detrimental implications for quality. With deregulation and the re-opening of the export market, the industry experienced a veritable renaissance. Nothing reflects this better than the increase of exports from 6% of total production in 1992 to 43% in 2015. Most of it, however, is exported in bulk and falls into the ‘basic’ quality category (Ponte, 2007). While the average quality of South African wine has undoubtedly improved since the mid-1990s, the financial rewards have been limited, because the margins in this segment are often wafer thin.

The trend towards ever bigger bulk exports is the reason why those voices in the industry that urge a reversal of this trend have become louder and argue for more value adding instead. In their appeal, they are echoing the conventional wisdom of global value chain (GVC) theory, viz. if a developing country firm wants to achieve a ‘better deal’ (e.g. earn bigger margins), they need to move up the value chain. They need to ‘upgrade’, for instance by enhancing the quality of the product or integrating more value enhancing activities such as brand creation (Ponte & Ewert, 2009).

The question is, however, whether co-operatives in developing country agriculture can actually achieve this. Given that approximately three-quarters of South African wine is still produced by ‘producer cellars’ (i.e. co-operative and ex-co-operative cellars), this is a key question regarding the future of the industry.

Pointing to the classical constraints of co-operatives some authors (e.g. Kyriakopoulos et al., 2004) argue that this is impossible. If co-operative wineries and their members are to stand a chance at all, they have to convert to a company. This will free the cellar from constraints and create more room for manoeuvre, e.g. sourcing capital on the open market or rejecting poor quality grapes. In the new era of South African wine approximately half of the ‘producer cellars’ have taken this strategic step. In some cases, the considerations were ‘political’, but in others the economic arguments were paramount.

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This paper investigates whether this conversion has actually paid off, that is, has the conversion delivered a more advantageous financial outcome when compared with those cellars that have remained co-operatives? We try to arrive at an answer via a number of steps: firstly, we recapitulate global value chain theory and its main argument regarding ‘upgrading’ as the core strategy to be pursued by developing country firms. We then discuss traditional co-operatives and the principles on which they are based. In this context, we address the main challenges that stand in the way when trying to enhance product and process quality. We subsequently apply the theoretical approach in a specific setting when we discuss the transformation of the South African wine industry over the last 20 years and the changing role of co-operatives and ex-co-operatives within it. Finally, we discuss four case studies in order to answer our main question: in their pursuit to adapt to a new environment which have fared better — co-operatives or companies?

Global Value Chain Theory and Co-operatives

In development studies, the concept of a value chain has been used to analyse international trade and activities that are required to bring a product from its conception, through design, sourced raw materials and intermediate inputs, marketing, distribution and support, to the final consumer (Gereffi et al., 2005; Staritz et al., 2011). In his early work, Gereffi (1994) draws attention to a process of almost ‘natural’ learning and ‘upgrading’ for the firms that join global value chains. Thus, developing country firms were encouraged to develop their indigenous capabilities through a process of technical upgrading in order to meet the standards of multinational enterprises, which play a key role as ‘lead firms’ in the transfer of new technology, skills and know-how (Humphrey & Schmitz, 2004).

In theory, there is no reason why wine co-operatives in developing country agriculture cannot achieve this. Several authors, however, have shown that the typical characteristics that define co-operatives (Barton, 1989; Cook, 1997) result in average, rather than better quality, wine (Dilger, 2005; Frick 2004; Pennerstorfer & Weiss, 2013). More often than not they go hand in hand with so-called free riding, horizon, portfolio, control, and influence cost problems (Cook, 1997). Others (Eilers & Hanf, 1999) have drawn attention to the fact that it is not clear who is the principal and who is the agent, i.e. both the co-operative and the members can be principals and agents. For this reason, neither leadership mechanisms nor selective terms of delivery can be enforced by the co-operatives, that is the members can deliver all the commodities that alternative dealers do not accept. This is the well-known problem of ‘adverse selection’.

One way of successfully overcoming the constraints of traditional co-operatives has been the introduction of ‘new generation co-operatives’ in the United States (Chaddad & Cook, 2004). In contrast to the traditional model, this restructured co-operative model is composed of individualised equity, non-member funding, closed-membership, proportional decision control, and the allocation of benefits through price differentiation and personal shares (Cook & Chaddad, 2004; Harris et al., 1996). South African wine co-operatives possess many of these features.

Another alternative is the wholesale conversion to a company. As mentioned above a number of co-operatives have made this radical break, because they see this as the only route to survival and commercial success. Whether it has actually turned out this way is the central question of the paper.

Backdrop: the New South African Wine Industry

Today the South African wine industry (SAWI) is hardly recognisable from the one twenty years ago (James, 2013). In just two decades, it has undergone profound structural change (see Table 1). Not only has production come to be focused on ‘natural’ wine (as opposed to distilling or fortified wine) and quality, but exports now amount to 43% of production — up from a mere 6% in 1992. In this, the co-operatives and former co-operatives continue to play a key role (Ponte, 2007).

Table 1: Structural Change in the SAWI, 1993-2015

	1993	2002	2012	2015
Total ha planted	82,833	94,412	100,568	98,597
White cultivars %	82	59	56	65
Red cultivars %	18	41	44	35
Total natural wine production (million litre)	857,389	746,485	1,012,771	958,400
Natural wine (% of total production)	46	71	82	83
Primary grape producers (n)	4,734	4,390	3,527	3,232
Producer cellars (n)	71	67	52	48
Private cellars (n)	173	310	505	494
Producing wholesalers (n)	6	11	25	24
Total no. cellars (n)	257	409	582	566
Exports (% of total production)	6	33	47	43

Source: Personal communication, Vinpro, 5 May 2014, and SAWIS, 2016.

The Regulation Era: Quantity Instead of Quality

As has been extensively documented elsewhere (Vink et al., 2004; Ponte & Ewert, 2007; Ewert et al., 2015) SAWI was tightly regulated for more than seventy-five years, between 1918 and the early 1990s. Suffice to say that empowered by law, a giant co-operative — the KWV (Cooperative Winegrowers Association of South Africa), came to regulate the industry in great detail. It was both ‘player’ and ‘referee’.

The whole system, however, started to unravel in the early 1990s, starting with the suspension of the so-called ‘planting quotas’ in 1992 and completed with the conversion of the KWV into a company in 1997 (Williams, 2007). With regulation something of the past, the co-operatives could free themselves from the stranglehold that the KWV and the producing wholesalers had frequently exercised. Co-operatives now had new options, selling to the estates, especially exporters who needed the additional quantity. Others could find their own market.

The New ‘Quality’ Era

The mid-1990s mark the start of the ‘new’ SAWI. Since then, several distinct shifts can be identified: firstly, the abandoning of the ‘brandy business model’ in favour of natural wine; secondly, within this category, a shift towards ‘noble’ cultivars (i.e. Chardonnay, Sauvignon Blanc, Cabernet Sauvignon, Shiraz, Merlot, and Pinotage) and ‘quality’; thirdly, the gradual development of a more differentiated product portfolio; and fourthly, the increase in exports. In a deregulated environment, most of this took place in an uncoordinated fashion, influenced little by the ‘strategic’ deliberations at industry level.

The first 10 years of the new era was characterised by a beehive of activity and innovation: the expansion of vineyards, the uprooting of ‘old’ and white cultivars and their replacement by ‘noble’ and red varieties, the expansion and modernisation of cellars, the professionalisation of staff, the ‘conquering’ of new markets and so forth. By the mid-2000s, however, market conditions started to deteriorate. Red wine prices started to plummet as a result of a global glut. The growers’ financial position was further aggravated by the onset of the financial crisis in 2008, customers ‘trading down’, and stagnating grape prices. At the same time, input prices kept on rising. This had a visible negative effect on the profitability of the ‘producer cellar’ sector. In 2012, the return on investment had declined to 11% from 17% in 2008. In the same year both the average cash flow ratio (0.38:1) and the own vs. loan capital ratio (27%:73%) were decidedly negative, indicating that neither the remaining co-operatives, nor the newly established companies were in a stable financial situation.

Amidst these negative trends, exports were on the rise again, driven by good harvests in South Africa, shortages in Europe, and a weakening Rand. By 2013, they amounted to approximately 50% of total production. Yet, at the same time, the value per litre actually declined. No doubt this trend has a lot to do with the continuous rise in bulk wines as a share of total exports. Since 2005 the latter has increased from 32% to 65% in 2015 (South African Wine Industry Statistics (SAWIS, 2015). Of this the co-operatives and ex-co-operatives produce the lion's share. Despite industry appeals for more value adding, the trend is actually going in the opposite direction. Why is that the case — especially since South African wine co-operatives have more room for manoeuvre than their counterparts in other wine countries of the world?

The Distinctive Features of South African Wine Co-operatives

After more than two decades of modernisation and upgrading, the number of co-operatives in the SAWI has reduced from 71 in 1993 to 48 'producer cellars' in 2016. Approximately half of these have converted into companies, leaving only a third that are true co-operatives. Whilst many have done this for political reasons, others have done it on economic grounds, expecting to reap efficiency and financial gains from the conversion.

Co-operatives in South Africa not only have a different founding history than their counterparts in other parts of the world (e.g. Languedoc-Roussillion, France), but also a different ethos and fewer traditional features. For instance, the raison d'être never included any socialist ideology. Instead, the motives of the (white) growers were straightforward and practical, viz. to pool resources and to improve wine quality.

With the support and encouragement of the Cape colonial government, the first producer co-operatives were established between 1906 and 1909. The next and most rapid expansion occurred between 1939 and 1949 when 27 new co-operative cellars were established, especially in the high production areas of the Breede River Valley (i.e. the Worcester and Robertson districts). The growth of the sector reached its apex in 1993, when there were 71 in total (Botha, 1966).

Although, in principle, there are no formal barriers to entry, most co-operatives consist of their founding members and try to keep it this way. One general hurdle is that the applicant has to be a grower; inactive membership is not granted. Also, an 'entry fee' has to be paid in the form of a capital investment, even if the payment is sometimes staggered over a number of years. A further defining feature is the 'pool' (of grapes/wine) — a separate legal entity that is managed by the co-operative on behalf of its members. It only charges the pool for the production costs. The pool itself is a non-profit company and pays no taxes. Pay-outs from the pool to members are staggered and so are their income tax obligations.

Deviating even further from the textbook definition of co-operatives, South African wine co-operatives are not bound to a simple one member, one vote system. Instead, a dual system of voting is the rule. While non-controversial or routine matters are decided by a show of hands (i.e. one hand, one vote), important issues are decided by the 'weighted vote'. Within the framework of the law every co-operative can devise its own system of voting rights (usually linked to the number of shares/tons delivered), as long as no member commands more than 20% of the votes. The 'weighted vote' is normally evoked in the case of key issues, like the election of the board, or changing of the statute. In these instances, voting takes the form of a secret ballot. This ruling has the obvious result that the bigger growers strongly influence decision making, including issues of investment.

Since the late 1990s, approximately half of the remaining co-operatives have converted to companies. As suggested earlier, in some cases this had little to do with business reasons. Instead the reasons were 'political', touching on the issues of access, accumulated assets, voting powers, and the legal identity of members. In other cases, the conversion was done decidedly for economic and business considerations. The thinking was that if the cellar wanted to banish the 'co-operative mentality' once and for all, replace 'productionist' thinking with a market orientation to achieve commercial success, it had to take this paradigmatic step and engage in own branding and marketing. The in-built flexibility of South African co-operatives was not enough. One had to make a radical break from the past.

Case Studies

Using a purposeful sampling method, we selected 14 producer cellars from 8 wine districts over a two-year period (2014-2016). Of the 14 cellars seven were co-operatives, and seven companies. Although we covered only eight of the 20 wine districts and the sampling was 'purposeful', we are confident that our sample is representative of the population of 'producer cellars' as a whole.

In all cases, except one, we used a questionnaire mailed in advance, supplemented by a lengthy interview with the general manager/CEO, in some cases assisted by accounting staff. Our approach was a holistic one, touching on the history, membership, voting system, division of labour, management structure, cultivar composition, 'quality' approach and other key organizational aspects. We tried to elicit both quantitative and qualitative data. By providing detailed information on history, plantings, prices, investment decisions, financial situation etc. we try to convey insight into how each cellar forged a strategy and business model in a new environment full of risks and opportunities.

After analysing the data, we discovered that only four of the 14 cellars pursued a value adding, self-marketing business model, that is they packaged 50% or more of total production in glass or plastic containers or bag-in-a-box. Of these an equal number (2) were co-operatives and companies. Although some cellars were packaging up to 30% of production, we decided arbitrarily to classify only those cellars as 'self-branding and marketing' that packaged a majority (50% or more) of total output.

For providing an insight into how the cellars forged a business model in the new era and the purposes of comparing the 'performance' of co-operatives and companies, we have selected four case studies: one co-operative and one company in low yield districts and the same for high yield regions. In the former, both cellars pursue a bulk wine model, while in the latter both cellars have decided on a value adding strategy. The identities of the cellars are kept anonymous, in line with an undertaking given to management. Instead they are indicated by letters as listed in Table 2.

Table 2: Comparison of Producer Cellars

Cellar	Wine district/ ward	Type	Ha	Av. yield per ha (tons)	Packaged (% of total production)	'Acid test' (i.e. cash flow)	Capital Ratio (own vs. loan)
A	Stellenbosch	Co-op	725	9.98	2.5	0.11:1	23:77
B	Robertson	Co-op	1800	17	2	1.71:1	56:44
C	Robertson	Co-op	2046	17	100	1.62:1	50:50
D	Stellenbosch	Company	Variable	Variable	100	Not available	50:50
E	Stellenbosch	Company	1222	8.13	3	0.51:1	52:48
F	Robertson	Co-op	1776	15.7	7.5	2.35:1	58:42
G	Robertson	Co-op	656	27	1	2.67:1	48:52
H	Worcester	Company	1406	21.6	30	0.40:1	36:64
I	Breedekloof	Co-op	916	17	30	0.53:1	75:25
J	Swartland	Company	1050	13	13	0.91:1	70:30
K	Paarl	Company	1842	8.2	20	0.38:1	32:68
L	Lutzville Valley	Company	2000	28	5	1.80:1	63:37
M	Lutzville Valley	Company	5000	20	88	0.98:1	30:70
N	Lower Orange	Co-op	4524	32	50	1.13:1	35:65

Cellar A: the bulk producing co-operative

This is a small traditional co-operative in the Stellenbosch district. It only has 16 members. Unlike most other co-operatives, each member has only one vote, regardless of the number of shares, i.e. there is no weighted vote. Together they farm 725 ha of vineyard. The average yield is 9.98 tons per ha. Red cultivars represent 70.4% of all plantings. In the Stellenbosch district yields are comparatively low and input costs high. The cellar tries to manage its cost by maintaining a small staff and a low degree of specialisation. Instead it buys in services when needed.

Over the last twenty years the most important innovation at the cellar has been the shift from a "70% white wine to a 70% red wine cellar", in the wake of a radical shift in market orientation. To make this possible, the cellar has invested R16.3 mill, most of it into the expansion and modernisation of the cellar, the tasting room, and image design. The latter included the wholesale name change, including the removal of the word 'co-operative', "because this is not good for the image of our wines, especially in overseas markets".

Almost 100% of production is drinking wine. The co-operative pursues a classical bulk production business model. 96.5% of its production is sold to one local producing wholesaler and one European exporter, who use the wine mostly for blending. Only 3.5% is sold in bottle through self-marketing, less than half of it in overseas markets. Essentially this amounts to a continuation of the 'business model' practiced in the regulation era — although the cellar did not think along 'business' lines then.

Regarding plantings, wine styles, cellar and vineyard practices, the co-operative mainly takes its cue from the producing wholesaler with whom it has had a long-standing, ('evergreen') relationship. Prices are negotiated from year to year. They are market related, i.e. the same intrinsic quality does not always fetch the same price.

Although the co-operative has not invested in value adding and self marketing, its financial indicators do not look particularly positive: in 2013 its cash flow ratio was 0,11:1 (compared to the sector average of 0,38:1) and the own vs loan capital ratio 23%: 77%, more or less in line with the producer cellar average of 27%:73%. No doubt, the modernisation and expansion drive at the cellar has left its mark.

Given the weak financial position, it is difficult to see how the co-operative could break its dependence on its biggest client and switch trajectory to self marketing, as the manager tried to suggest. This is probably more wishful thinking than a real option. Farming in a region of high cost and low yields, the sixteen members appear to prefer playing it safe.

Cellar K: the bulk producing company

This cellar is situated in the Paarl region where low yields (i.e. less than 10 tons per ha) are the norm. It is the only true company in our sample in the sense that it has jettisoned all remnants of a co-operative structure or culture. For instance, it no more functions according to the pool principle. Instead it has contracts with its shareholders growers and independent growers. This means that it can reject grapes which do not comply with the agreed quality standards. Another novelty is the 30% shareholding by outside, non-growing investors.

Founded in 1941 the cellar converted to a company in 2012. Although the conversion to a company was primarily for political reasons (i.e. the threat to the weighted vote), once the decision had been taken, the transition was wholesale and radical. Two years on, during the interview, management was keen to point out the economic advantages that have come in its wake: "We can act more independently, the board is not that involved in day-to-day decisions ... We are under pressure to make a profit. That promotes efficiency".

Today the cellar has 32 shareholder growers. Together they farm 1842 ha of vineyard, with an average yield of 8.2 tons per ha. In the five years before the interview the growers uprooted almost 80 ha and replanted 161 ha. The most planted varieties are Chenin Blanc, Cabernet Sauvignon, Pinotage, and Shiraz. It is primarily known as a red wine cellar.

The most important changes over the last twenty years include infrared vineyard mapping, the appointment of an in-house viticulturist, entering the packaged market, the development of an international focus and the introduction of equipment that puts the cellar in a position to make wine "ready to bottle" (i.e. 70% of total production) and supply "the full package" — and the conversion of course.

The four years prior to the interviews were described by management as "good years and a period of recovery" after the onset of the financial crisis in 2008. The cellar takes pride in the fact that the pay-outs to its members are amongst the top three in the producer cellar sector. However, this comes after a difficult period of 10-15 years. In the early part of the new millennium, when the cellar was still a co-operative and grape prices were relatively high, members received generous pay-outs. At the same time the cellar decided to buy another production facility (i.e. cellar), overextending itself in the process. It still suffers from the debt incurred then. This clearly makes itself felt in the own versus loan capital ratio (see below).

In 2008, the cellar experienced another crisis when one of its prominent members, responsible for 35% of production, decided to leave the cellar and establish himself as an independent producer. Although management did not want to elaborate, this may have been related to the weak financial position of the co-operative at the time. Whatever the precise circumstances, the departure of the large producer suddenly left the cellar with large unused capacity. In order to address the problem it accepted two new growers — without the latter having to buy up shares. This in turn caused considerable dissatisfaction amongst the existing, founder members.

The exit of the key member seems to have gone hand-in-hand with the wholesale change of the management team. The current Managing Director was appointed in 2007, having previously worked for the biggest producing wholesaler in the industry. The current financial manager and the first in-house viticulturist were appointed at more or less the same time. In addition to these specialised personnel, the cellar also employs three wine makers and a full-time marketing manager. At the board level there is a division of labour regarding production, financial, legal, and marketing matters.

The cellar's business is almost exclusively natural wine (99%). Although it has entered the packaged market, 80% of production is bulk, which goes into 'established brands'. With these clients the cellar has long term relationships. As management put it: "We know where our wines go". The cellar is also involved in joint ventures. Amongst others, it has a 30% stake in 'branded exports'.

An important element in the cellar's strategy is wine bought in from high production areas. These volumes are considerable and blended with the wine from its own growers (both shareholders and independent). The strategy makes economic sense, because prices are significantly lower than in districts like Stellenbosch or Paarl. 62% of production is sold in overseas markets, the main export markets being Germany, the UK and Russia. One client in Germany buys 35% of total production on the basis of a three year 'rolling contract'. The cellar is also involved in several other joint ventures with international partners.

At the time of the interview, the bulk business model pursued by the cellar, which includes the buying and selling of wine on the open market, produced a mixed financial picture: on the one hand, the pay-outs to its shareholders are amongst the highest in the sector; on the other hand, both the capital and the cash flow situation look less rosy: the own vs. loan capital ratio was 32%:68% and the 'quick ratio' 0.38:1.

According to management, the debt incurred in the co-operative era still weighs heavily on the financial situation, resulting in high interest payments. However, the cellar is confident that it will remain competitive, because of a "ten year upgrading plan", the most important objective of which is to "maintain the highest pay-out position to allow its shareholder growers to replant and expand". In all this management is convinced that the conversion to a company does make their job easier.

Cellar C: the value adding co-operative

Today this cellar is one of only a handful of co-operatives that have pursued the value-adding, self-marketing business model and made a financial success of it. Founded in 1941 the co-operative has 48 grower members that together farm 2,346 ha of vineyards. The average yield is 17 tons per ha. White grapes represent 55% of all plantings, red grapes the rest. The most important white varieties are Chardonnay, Sauvignon Blanc, Chenin Blanc, and Colombar. Amongst the red varieties the most important plantings are Cabernet Sauvignon, Shiraz, Merlot, and Pinotage.

The cellar only produces natural wine. This is a radical switch from the situation in the mid-1980s when production was still geared to rebate and distilling wine. Then natural wine only constituted 20% of total production. In addition to its own production the cellar also buys in wine, with the latter responsible for 46% of total production. All wine is packaged in the in-house bottling plant. 30% goes into 750ml bottles, 56% into bags-in-a-box and 14% into tetra pack type containers (so-called 'kombi-blocks').

In the domestic market the cellar's wines are distributed and sold by a distribution firm in which it has a 50% stake partnership in brand holding and bottling. The distribution company sells the packaged wine after buying it from the partnership, but the brand holding company does the marketing for the brand. In the international markets, the wines are marketed by an export company, also owned by the cellar and the distribution company on a 50:50 basis. The domestic market represents 81% of all sales, with the other 19% sold in overseas markets. The cellar's most important international markets are: Sweden, Canada, Denmark, UK, and USA. These represent approximately 60% of all exports. The most important new growth markets are South Africa, Africa, Russia, the Baltic countries and China. For the "difficult" USA market, the cellar has established its own import company. Over the last five years the cellar's sales have grown by an average of 15% p.a. In 2015 they grew by 22% in the combined domestic and international markets. Growth in the domestic market alone was 30%. Partly responsible for the latter is an apparent breakthrough into the black urban market, more specifically into the young (25-35 years) aspirational female market which appears to prefer 'natural sweet' red and rose wines to beer and spirits.

Over the last 20 years the cellar has invested R200 mill into expansion, acquisition and modernisation — mostly through bank loans. In the 2014-2015 financial year the cellar's own vs. loan capital ratio was 50:50. Its 'cash flow ratio' 1.62:1, i.e. with debtors and cash outweighing the cellar's creditors. Today the cellar's brands hold the no. 2 position in both the high price (HP) and the medium price (MP) sectors in the domestic market (SAWIS, 2015). The major force behind this astonishing development from a (mainly) rebate cellar in the 1980s to a top competitor in the natural wine market is the cellar's CEO. Appointed in 1982, the manager was set on entering the packaged wine market from the start. Before his appointment he had been the cellar master at a co-operative in the Swartland district. The latter is blessed with some good red wine terroir. He tried to exploit this by bottling a certain percentage of the production and selling it with success at the cellar door.

After having been appointed at the current cellar, the manager discovered that one of the members was producing some good Cabernet Sauvignon grapes, 20 ton in all. Because the board of directors were not willing to invest in oak barrels, the manager and the farmer in question decided to pursue the idea with their own capital. As it turned out, the red wine was a success, to the extent that the board had a complete turnaround and were now willing to spend money on oak casks.

Proving that value adding could work, the CEO then proposed that the cellar pursue this as its business model. Although the CEO had the backing of most of the members, some of the directors resisted, including the chairman. One of the directors, a chartered accountant, warned that this strategy would soon result in bankruptcy. More opposition came from the KWV and the producing wholesalers (i.e. the ’trade’). The local KWV representative threatened to make life difficult for the cellar, whilst the trade were openly blackmailing the CEO by threatening to buy no more bulk wine should the cellar enter the packaged market with its own products. This all happened in the mid/late 1980s when the regulation regime and with it the KWV’s rule was still firmly in place. However, new important shifts started to occur at the same time, eroding the power of the main players. For instance, supermarkets were starting to sell wine on a hitherto unprecedented scale. This happened against a backdrop of deregulation of agriculture sanctioned by an otherwise authoritarian apartheid government.

The CEO, supported by the new board, identified this opportunity, thereby catching the trade unawares. The latter were still in their comfort zone relying on the dominance of their retail chains. Convinced of pursuing the right strategy the CEO procured used bottling equipment in Europe ’for next to nothing’. As a first step towards self-marketing the cellar started to produce bag-in-a-box wine for the house brands of most SA supermarket chains.

Learning from the mistakes of other co-operatives who were also venturing into self-marketing, but relying on personal networks for that purpose, the cellar started to launch wine tastings. Realising that own marketing would overstretch the cellar’s resources, it got into a joint venture with a professional marketing firm that had just entered the changing wine scene in South Africa. The latter bought a 50% stake in the bottling plant and the cellar brand, injecting much needed capital into the co-operative. The agreement was that the firm would be the sole marketer for the cellar in the domestic market. It established warehouses in Johannesburg and Durban and sold the wine through its network of sales representatives. Whatever it could not sell went back to the cellar for which the latter had to find alternative markets.

This arrangement has been in place for almost 30 years. Over this period the cellar has enjoyed constant growth, rising to an average of 15% over the last five years. Partially responsible for the success has been the continuity at the board and management level and the persistent pursuit of the value-adding business model. Also of key importance has been a sound financial policy. The dictum of the CEO has been to “only pay the members when the wine has been sold” and “never pay them with borrowed capital”. So far this policy seems to have served the cellar well.

Cellar M: the value adding company

The idea that a company may be a better organizational vehicle for reaching its objectives played a key role in the case of cellar M. Having been one of the largest co-operatives in South Africa for most of its existence, the cellar converted to a company in 2006. This step was preceded by almost ten years of modernisation and upgrading.

This huge cellar with a pressing capacity of 110,000 tons it is still one of the largest cellars in South Africa. It is located in the Lutzville district where yields of 40 tons per hectare were not uncommon in the regulation era. On the 160 farms (owned by 202 members) a total of 5,000 hectares of vineyard are cultivated. 69% of all vineyards are under white varieties, with Colombar and Chenin Blanc being the most prominent ones. In 2014 the average yield per hectare was 20 tons.

Decisions are taken through the system of ‘weighted votes’. A member is allocated 500 shares per ton, up to a maximum 20% of the votes. The members own the shares in a holding company which controls several affiliates, including a distribution company. Over the last 20 years the cellar has gone through profound change, essentially shifting from distilling wine and grape juice to natural wine production. To make that possible it not only invested heavily in processing, wine making, and fining facilities, but also introduced its own in-house packaging lines — a key component of the new business model.

The process of transformation was set in motion by the appointment of a new general manager in 1996. He launched the cellar onto the box wine trajectory by installing the first packaging line in 2001. At first there was resistance against the new course, but he managed to convince the members and get their support. Since the late 1990s they have committed to R254 million of investment — with 75% generated by their own income, and the rest provided by bank loans.

Cellar M does exactly what GVC theory suggests, viz. package the wine, create its own brands, and sell them through self-marketing. Approximately 97% of its wine is sold in packaged form, almost all of it 'bag in a box'. In order to have more control over the supply chain, the cellar established its own distribution network in the domestic market. This delivers directly to supermarket chains, liquor groups and independent liquor traders in both the urban and the rural markets. The export market is managed by a specialist marketer and logistics staff in Cape Town, near the harbour and airport.

In 2013, 90% of production was natural wine. 85% is sold in the domestic market, the rest overseas. In the local market 99% is sold under its own label, 20% in international markets. In 2013 the most important international market was France, followed by the UK and Germany. According to the manager the cellar has established itself as "the no.1 volume brand" in South Africa. In the UK market its brand was amongst the top 20. Despite the commercial success, the cellar's financial situation is not particularly positive.

Due to a heavy investment programme over many years the capital ratio was 30%:70% in 2014. The cash flow situation was better at 0.98:1. The debt was clearly on the manager's mind when he emphasised the need for "higher profitability of the current infrastructure". However, he noted simultaneously that "expansion may be necessary to guarantee organic growth of the business". He was fairly optimistic that these goals could be reached "judged by results in more recent times and if conditions remain more or less the same".

Summary Discussion

Judging by the four case studies above, those cellars that converted to companies do not emerge as clear 'winners'. On some of the indicators a company may do better than one of the co-operatives, but the opposite is also the case. Put differently the conversion to a company has clearly not delivered the expected financial results — at least not at this stage. Their financial stability is not consistently superior to that of the selected co-operatives (see Table 2).

Of course, it can be argued that the selection of the cases above is arbitrary, but the position does not change when all 14 are looked at: the average capital ratio for all co-operatives in our sample is 49:51, compared to 46:54 for the companies (company cellar D was not included in the calculation as they did not furnish cash flow data). This also goes for the cash flow situation. Also here the co-operatives are in a better position: 1.44:1 compared to 0.83:1.

Conclusion

What do these figures tell us? Clearly where former co-operatives have converted to companies for business reasons the economic assumptions underlying the conversion have not been realised. At least for now the conversion has not delivered superior financial stability. On the other hand, it is also the case that not all co-operatives have consistently 'performed' better than the companies in our sample.

This leads us to the conclusion that it is not the organisational structure that matters, but the business model. On average the company cellars are financially less stable not because of their different management and decision-making mechanisms, but because of their bigger capital investments into equipment, branding and self-marketing.

Although the number of cellars that package 50% or more of their production is the same for both companies and co-operatives (2 out of 7), the detailed case studies of all 14 cellars reveal that on the whole the companies have made bigger financial commitments. In some cases (e.g. cellar B), the value adding business model went badly wrong, incurring huge debts — something from which it is only now starting to recover. Cases like these weigh heavily on the company average.

By engaging to a greater extent in the bulk business model, the co-operatives have avoided some of the high costs involved in value adding. Where value adding has been successful in the case of a co-operative (e.g. cellar M), this is due to shrewd strategic decision making on the part of management and not the co-operative structure. Therefore, what this sample of case studies tells us is that organisational form is not decisive. The company model is not a guarantee for 'success', but neither is the co-operative. What matters more are strategic management and a viable business model.

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