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LINKING UP THE VALUE CHAIN:

Assessing The Inter-Firm Linkages That Make Up The
International Global Value Chains Of South African
Wine And Its Effect On Pro-Poor Economic Growth



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Abstract: Global value chains are essential to understanding globalization in the nature of export-oriented markets and commodity flows to end-markets. Developing countries have experienced a recent wave of economic structural adjustment and introduced export-based reforms as an approach to pro-poor growth. This thesis takes South Africa's post-apartheid wine industry as a case study to understanding the actors who are included and excluded from such a value chain. Little has been studied in the development literature on applying a full-scale value chain map to such a case. This thesis attempts to do so and assesses the value chain linkages and the challenges firms face to upgrade up the chain to create the most added value. The study is assessed in relation to the author's self-generated, case-appropriate theoretical value-chains framework based on selected conceptual tools. Explaining the difficulties South African-based firms have in upgrading is discussed in relation to the country's historical implications and how post-apartheid South Africa has influenced the social and economic marginalization of certain actors within the wine industry, which ultimately has also influenced impoverishment. But as the analysis and conclusion shows, more South African wine laborers who were historically excluded from the industry are now being economically included – but their poor income levels are perpetuating their impoverishment. Policy makers can learn from this in determining if they should continue their focus on economic inclusion or if it is now time to promote narrower income gaps.

Keywords: Global Value Chains; Wine Industry; South Africa; Poverty Reduction; Pro-Poor Growth; Economic Inclusion and Exclusion; Value Chain Upgrading

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List of Acronyms

AERC	African Economic Research Consortium
ANC	African National Congress
BD-CC	Buyer Driven Commodity Chains
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Global Commodity Chains
GDP	Gross Domestic Product
GMO	Genetically Modified Organisms
GVC	Global Value Chains
IMF	International Monetary Fund
NAMC	South African National Agricultural Marketing Council
PD-CC	Producer Driven Commodity Chains
PRS	Poverty Reduction Strategies
PRSP	Poverty Reduction Strategies Papers
R	South African Rand
SAP	Structural Adjustment Programs
SAWIS	South African Wine Industry Statistics
SPS	Sanitary Standards
TRIPS	Trade Related Aspects of Intellectual Property Rights
USD	United States Dollar
WB	World Bank
WIP	Wine Industry Plan
WTO	World Trade Organization

1. Introducing the new South Africa

The South African press in 2003 described the South African wine industry as entering ‘the new South Africa’ (du Toit, et al., 2008:6). This enthusiastic and congratulatory event was based on moving away from the notorious, and exploitative conditions of wine laborers during apartheid. A plan emerged, known as ‘the wine industry plan’ (WIP) that presented a strategy to move away from the cruel past. The idea was to bring a shift from the formerly white male based leaders of the industry and a move towards an increase in industry participation by a wide range of new stakeholders. As a result, ‘Black Empowerment’ became a central element to the discussion (*Ibid.*, p.7). The WIP acted also as a response and strategy to the international community for lifting their sanctions on the country, for South Africa could now send their production outwards.

It is well noted that diverse agricultural production is vital to the country’s economic development (Stringer, 2001:7). The wine industry in democratic South African has provided 300,000 people with formal employment (Meissenheimer, et al., 2001:6). In 1998, South Africa earned R6,988 million in revenue, while R792 million was earned as a result of wine exports. The wine industry has contributed R11,672 million to the country’s GDP. As a result of these totals, studies have shown that for every Rand invested into the wine industry, R0.25 is generated for South Africa’s GDP (*Ibid.*, p.10.). South Africa has also seen 5.3 new jobs for every R1,000,000 (\$150,000 USD) invested in the wine industry (Du Plessis, 1999, found in Meissenheimer, et al., 2001:10). This progress and statistics have both been recent achievements. New production technologies have also been adapted and more attention has been placed on marketing to meet the buyer needs and a demand-driven product design (du Toit, et al., 2008:12).

The chain of events after South Africa’s place in the export market led to the release of ‘Vision 2020.’ This became a new strategy for the research and consultation needed for, what the strategy describes, “innovation driven, market directed, globally competitive and highly profitable industry (*Ibid.*, p.15).

It has now been nearly 15 years since the end of apartheid. Moving forward and developing the wine industry have also brought discussions regarding the problems of land reform, the division between commercial farmers and farm workers, and deracializing the domestic economy. One other issue, albeit very controversial, has been the effect of worldwide integration into the global economy, which has been seen as an opportunity for income growth (Kaplinsky, 2004:3).

The discussions on restructuring have been notable in the academic literature due to the ideas presented by Ewert and du Toit (2005). They argue that restructuring has created a 'double divide' in the wine industry. The division is between those who reaped the rewards of the wine industry and between the laborers who lost out on the export opportunities.

This double divide can be observed in many instances within Africa's wine sector. On one hand, there is an apparent actor who controls a wide range of decision-making power regarding the path of the wine sector. On the opposite angle, farmers who most commonly are poor, have yet to reap the rewards of being included in the wine industry.

1.1 Problem Field

The unequal relationship represented by the double divide can also be seen as a critique regarding the globalization process and how the poor have not yet participated in it. Exclusion can also be associated to those who are at risk from socio-economic or political isolation, which will ultimately minimize their opportunity of integration and empowerment. In the case of South Africa's wine industry, actors on both side of the double divide, in essence, become part of a power struggle. Not being able to integrate as an economic link, for example, to the wine industry, will be of consequential concern to the excluded, for they will not be able to mainstream their agricultural production.

Studying such links, and with the help of global value chains (GVC), the globalization process can be more apparent by linking a range of actors together to assess what firms create what economic value of wine.

In relation to this problem field, this thesis will become a study and investigation of the following:

What economic impact have the South African value-chains of wine had on benefitting poor households working among the wine sector?

The following four sub-questions will be researched to help construct the analysis in order to answering the above question:

- What does linking together the firms of South Africa's wine industry and mapping out the value chain tell us about the economic inclusion or exclusion of the poor?
- What difficulties do firms face in creating more added-value to the value chain?
- Does the location of the firm create an indicator for how much value the firm adds to the chain, whether it is based in South Africa or internationally?
- What contributions have the post-Apartheid South African governments had on including the formerly excluded non-white populations to enter the chain?

1.2 Reading Guide

In order to better understand how these questions will be answered, the following will provide you with an overview of how this thesis will take shape. The next section will offer a discussion on the applied mixed-methods methodology to help ensure validity and objectivity of the research. *Section 3* will build and generate a value-chains framework that is best suited for this thesis and the object of study and analysis. *Section 4* puts the value chains of wine in focus by looking at the backdrop of South Africa's wine industry: the macro-economic environment and South Africa's post-apartheid policies of land distribution and poverty reduction. *Section 5* maps out ten chain actors in South Africa's wine-based value chain and their linkages with each other. *Section 6* discusses the major points found in the study and clarifies on answering the questions asked in the problem field. *Section 7* will recapitulate the main discussion points with a conclusion and then end with final remarks.

2. Methodology

The methodology of this thesis will be guided by two structural components. First, I will develop my own theoretical framework based on selected conceptual tools for studying value chains. Secondly, I will take this framework and apply it inductively to the case study of South Africa's wine industry. The term case study however is generally considered in relation to a particular event, either historical or current, that can be written within a narrative of a particular subject. This thesis however will instead take a collection of case studies and consolidate them into a case study relevant for a value chain approach and analysis. In other words, I will collect several studies of the South African wine industry and sew them together into one value chain case study.

Applied methods will be both quantitative and qualitative, and both primary and secondary sources will be applied.⁴ Applying this framework will best allow analysis and discussion of the relationships between all studied actors in the global value chain. The following will discuss in detail the conducted research methods.

Quantitative data will be applied in the study by the form of gathering statistics regarding macro-economic data: capital and value flows, income and distribution statistics in relation to South Africa's domestic wine economy and international wine markets. I will be looking particularly for all relevant domestic and international trade data that will help provide an overview of active firms within South Africa's wine industry is. I will also be looking to narrow down the industry and locate particular lead firms.

Qualitative data will be applied in the form of case studies. I will first narrow down a list of lead firms within the industry, and then find relevant literature that studies these firms as individual case studies. This will then guide me to the actors that have influence (both positive and negative) on the studied firms. This approach will guide me to tie a link to actors and services and show their relationships with each other. A literature review will be made to gain insight

⁴ Cover photograph is licensed Creative Commons.

in what discussions and conclusions regarding the topic have been made and to understand where research is lacking on the topic. The review will also help knowing where knowledge gaps are and help motivate the research of this thesis because research on the topic is needed.

Studies of actors in relationship to South Africa's wine industry are not new to the development literature and are increasingly being discussed. However, these studies all face the limitation that they focus on a single actor, instead of placing all actors together within the study to assess relationships between each other. This limitation is what this thesis will overcome.

The ultimate goal of applying these methods will be to complement each other and increase the objectivity, reliability and validity. This methodological framework will act as a design framework to explore the relationships with actors and the influences that they may have on each other. Once data has been collected, the data will be analyzed and the relationships between actors in the GVC will be assessed in relation to the framework found in *Section 3*. GVC analysis is also based on a methodology that applies the concept in different ways based on the question of investigation. This methodology will be best allow me to identify which actors are relevant to trace, understand, and assess firms and their relation to any given stage in the value chain and also to help find patterns that show certain governing power relationships.

2.1 Study Limitations

The limitations of this thesis will primarily come from accessing the relevant data needed to create an absolute financial figure that can be applied to know the exact amount of value that actors add within the GVC. Such financial data is not typically disclosed publicly (Gereffi, et al., 2001:7). Outside of the poor quantitative data and record keeping held by African states, international institutions such as the IMF, World Bank, and AERC however have their own data which accounts for 90% of Africa's trade (Gibbon & Ponte, 2005:36). In some cases when official data is absent, wine firms have used consultants to help provide economic data that would have otherwise never been gathered. Such data

has also been applied to this thesis when needed. The limitation to such data is the absence of peer review prior to publication.

It is also recognized that because of the limitation from certain dimensions, especially political aspects of poverty reduction and economic growth, the theoretical analysis of the wine industry's economic impact on poor households will not be all encompassing, as it is understood that political impediments have also influenced the lack of economic development and distribution.

Acknowledging that the development of wine is based on the agricultural production of grapes, a number of considerations must be made in relation to deciding how certain external non-economic factors, e.g. environmental factors, can impact the value chain. These factors however are considered only as secondary explanations and not directly associated with the value chain analysis. Many debates have emerged within agricultural development. Some of these debates will not be considered, while some points will be assumed.

This thesis will not take into account the potential of external business providers to deliver genetically modified organisms (GMO) or any other genetically engineered crop enhancements, including insect resistant crops. This thesis will also not consider the debates regarding the efficiency of pesticides or fertilizers. It is assumed that all processes within the value chain will move upwards without the threats of economic instability, a decrease in consumer spending or any other external threat that would motivate the consumer to not purchase wine. It is also assumed that all soil and crop output will be constant, and it is beyond the means of this thesis to consider any threats as a result of global climate change, political instability, or civil and/or political chaos in South Africa or by their neighbors.

3. Building a Case-Appropriate Theoretical Framework

Since the early 1980's, there has been a strong political movement originally represented mainly by developed countries for states to liberalize their economies, guided by an export-oriented approach. However, North America, Western Europe, and Japan still carry the bulk of all global trade flows (Gibbon & Ponte, 2005:2). Africa on the other hand has had minimal trade flows and has relied primarily on agricultural commodities as their leading exports (*Ibid.*, p. 1). Even with Africa's participation in globalization, the developed countries that originally advocated for liberalization in the 80's are the same ones currently participating in the bulk of economic globalization. The countries with the most advanced economic markets have also remained the same in comparison to 1910 (*Ibid.*, p. 4). This has been partly due to the fact that most of the value within global exchanges of trade flows has been based in the manufacturing sector. Contrary to this, developing countries on the other hand primarily rely on their agricultural sector for their economic development. But as we will also see in the course of this thesis, studying wine under the framework of value chains shows that wine is a commodity that needs commitment among a wide range of sectors, including the primary, secondary, and tertiary (which has been earlier observed by Anderson, et al. 2001:5).

The term trade flows does not imply that consumers in a particular country can automatically take part in the economic consumption of a particular trade or commodity even as the commodity flows past them. During the 1980's, almost all leading retailers that intercepted and sold off a particular commodity only did so in their hosting country. Today, this has now changed. Retailers are now more than ever dominating world trade sells and are doing so outside of their domestic markets (*Ibid.*, p. 7). Unfortunately, these hosting trends still do not look favorable for Africa. As retailers expand outside their home borders, Africa has not hosted such leading firms. This is not to say that that modern retail stores do not exist in large urban Africa cities, but they have not attained market leadership compared to their retail counterparts in developed countries (*Ibid.*, p. 17). This has

shown that even though globalization has an arguable beginning, it does not have a finishing end and it thus a never-ending process. Today's globalization followed by tomorrows will have new trends, actors, and emerging links (*Ibid.*, p. 7).

The retailers hosted in developed countries also carry a competitive advantage by way of the shareholder value doctrine. This doctrine dictates that equity markets brought out by rapid growth and price inflation have led to greater opportunities (Gibbon & Ponte, 2005:11). Lead firm retailers have also implemented a cash flow strategy, in which they only open for operations in locations where they feel their market leadership is a near guarantee (Gibbon & Ponte, 2005:13). This is the foundation of oligopolistic rent seeking, which retailers aspire to do.

The implications mentioned as a result of globalization: market liberalization; unequal access and distribution of trade flows; access to the sale of commodities; and firms competing for competitive advantage have influenced the study and the proposed theoretical framework for this thesis. As will be discussed later, the applied value chain framework is built on the basis of three interlinked theoretical concepts, which make up the analytical core of this thesis: 1) Global Value Chains, 2) Chain inclusion and exclusion and 3) pro-poor economic growth.⁵ The following will offer a brief discussion on these concepts and secondly, a brief discussion in relation to South Africa, which later will be applied in the analysis.

3.1 Global Value Chains

GVC is not an original concept. It has its conceptual roots taken from the study of global commodity chains (GCC). This form of analysis is principally concerned with understanding how global industries are organized. It consists of identifying the full set of actors (i.e. firms) that are involved in the production and distribution of a particular good or service and mapping the kinds of relationships that exist among them (Bair, 2005:157).

⁵ Poverty reduction and pro-poor economic growth will be later discussed in *section 4*.

GCC was first introduced within a business framework to understand the global nature of a commodity. The chain describes the link from the manufacturer all the way to the consumer and beyond. The field of development studies however took such a framework and broadened it to fit the process of globalizing economic integration. But as anyone familiar with development studies knows, multiple definitions of development exist. As a consequence, there has been dispute over how GCC is framed within the development context. One particular idea that is acknowledged when applying a GCC framework is the need for GCC strategies to be tailored to the research in question (Gibbon, 2001:345).

GVC and GCC are commonly used interchangeably, but their differences are apparent once understood. GCC refers to understanding the global linkages between firms from production to end market. GVC on the other hand looks at what value firms between the production and end market create for the end product. In order to do this, GVC must also rely on some aspects of GCC in order to have a proper understanding of what firms are responsible for what services within the chain.

World-system theorists have fused and applied GCC with the core-periphery distinction within world-systems theory as a process of unequal distributions of capital. The location of where capital is invested constitutes the single most important aspect to defining the global division of labor and how the global economy is bounded (Described by Bair, 2005, originally discussed by Arrighi & Drangel, 1986).

The original business perspective of GCC in analyzing the steps involved into the transformation of raw materials into consumed commodities is also applied to the world-system approach. But this approach also includes the interconnected web of actors and institutions and their decisions that are made within the chain. All decisions either implicitly or explicitly impact the next actor or institution that is linked on the chain. World-systems theorists are most fundamentally interested in how commodity chains are structured and how as a result, a stratified and hierarchical world-system is reproduced (Bair, 2005:156).

With GCC as the foundation, GVC provides a way to map and analyze the international division of labor. Value chains are tools that enable one to study the operation of global capitalism beyond the territorial confines of the national economy (*Ibid.*, p. 156). Studying value chains help provide a more analytical understanding of the global integration of particular commodities that are available worldwide (Gibbon, 2000:1). For the previous studies that have used a GVC approach, there has been a notable absence in researching the possibilities for firms to create more value to upgrade in the chain (*Ibid.*, p. 2).

The methods of how value chains can be studied and applied as a theoretical framework are also contested. Studies have been made in mapping the chains of the clothing industry, automobiles, and technology, among other sectors. Each of these sectors is studied with value chains as a framework, but the concepts within the chain analysis are different. Deciding upon which framework for what industry must be motivated, and as a result, studying South Africa's wine industry in relation to pro-poor economic growth must be specific to the case and cannot be assessed with a standardized framework applied to other sectors. This is evident when considering how the automotive or technology industries are studied and cannot be applied when considering basic agricultural-based commodities. With this in mind, there are many approaches to study value chains.⁶ The following described framework however is best suited for this thesis.

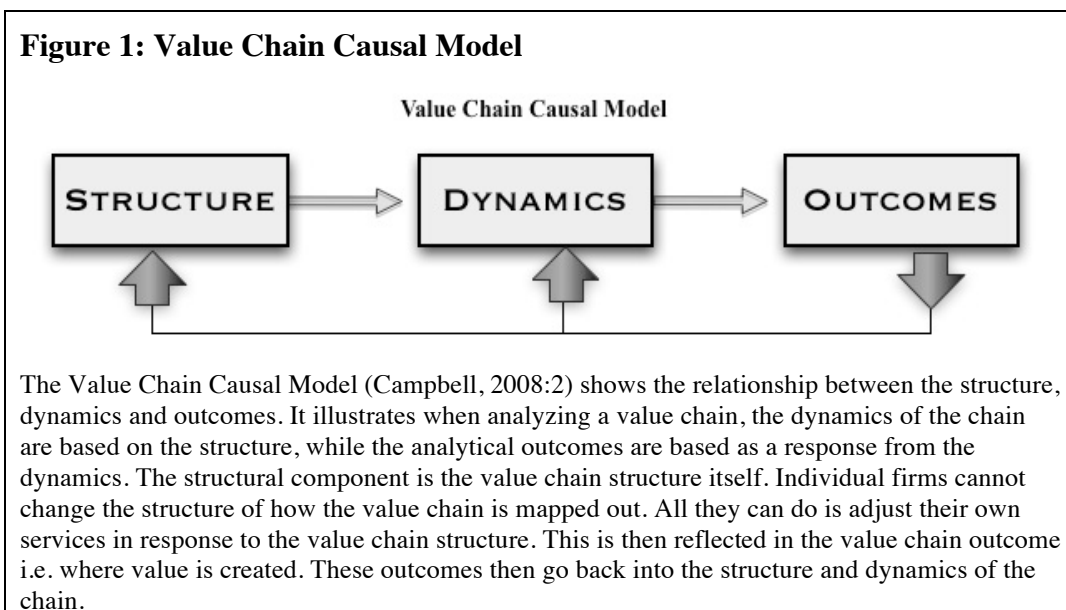
Within the GVC literature, sub-concepts exist for the purposes of building the GVC framework for the analysis of this thesis: 1) Gereffi's dimensions; 2) vertical and horizontal linkages; and 3) the end markets, business environment & development services (section 3.1.1). This is followed by value chain upgrading and downgrading; value chain governance; producer driven/ buyer driven firms; and inter-firm relationships (section 3.1.2).⁷

These sub-concepts can be organized within two components of the value chain: structural and dynamic (Campbell, 2008:2). The structural component is a

⁶ See *Appendix II - Five Global Value Chain Governance Types*, for a mapped theoretical explanation of how such chains can look like for other industries.

⁷ See *Figure 5: Operationalized Value Chain Framework* for a guided visual model of these concepts, which will also be discussed next.

way of building and organizing the value chain of individuals and firms to help understand how a commodity moves forward. The dynamic component is based on the decisions of individuals and firms that are made as a result of how the chain is organized as a result of the structural component. The outcomes are then reflected back to both the structural and dynamic factors to assess the efficiency of the chain and remove remaining gaps in the value chain. The following figure depicts this relationship:



3.2 Structural Factors

When analyzing the value chain, structural factors help create the web of firms and positions them on the value chain based on where they are linked within the chain. For organization purposes, the closer the actor is to the production process, the closer they are to the bottom of the chain. Placing them on the bottom is primarily based on a location scale, which helps illustrate that they are positioned locally in South Africa within the vertical chain. The higher up an actor is within the chain is symbolic to their position to the international market. For instance, firms that are placed higher up on the chain can be represented by firms working within the export process, retail firms, or end market buyers.

3.2.1 Gereffi's Dimensions

Gereffi has created a framework based on three dimensions for building a value chain (Gereffi & Korzeniewicz, 1994:97). 1) The input-output structure, which considers the linkages and sequences between firms that create economic value in either products or services in a particular commodity chain. 2) The territoriality dimension, which considers the location of distribution networks, either locally or international. This helps assess the global nature of how commodities are transformed during the primary phases of production to the final purchase. 3) Lastly, he includes a governance structure to help assess how financial, material, and human resources are located and distributed within the chain. But for the purposes of this thesis, this third dimension however is best applied as a dynamic factor and is discussed more section 3.1.2.

3.2.2 Vertical and Horizontal Power

Assessing the actors and their power over each other can be discussed in relation to vertical and horizontal analysis. The vertical analysis is based on the relationship between actors within the chain and the flow of products/services, information, inputs, and finance between each actor (Ponte, 2008:14). On the other hand, horizontal analysis can be described as the study of how the vertical chain affects the small-scale participants and non-participants that are influenced by firms in power.

Thus vertical analysis can be analyzed by the power a firm has in relation to governance and coordination (Bolwig, et al., 2008:5). A firm moving upwards, or vertically, can be described as a scenario where the firm is then in a power position that can influence demands and have control over the value chain. This includes, among other processes, certification systems, the linkages between the divisions of labor, and controlling how these linkages must perform.

While vertical analysis follows the firms in the value chain, horizontal analysis follows the poor and their inclusion or exclusion of the chain (*Ibid.*). This provides a poverty dimension to the analysis. The poor's income and resource accessibility is highly dependent on the factors within the vertical analysis.

Horizontal analysis is also commonly used in relation to livelihood strategies, and to assess the poor's vulnerability, risk, and inequality (*Ibid.*).

3.2.3 End Markets, Business Environment & Development Services

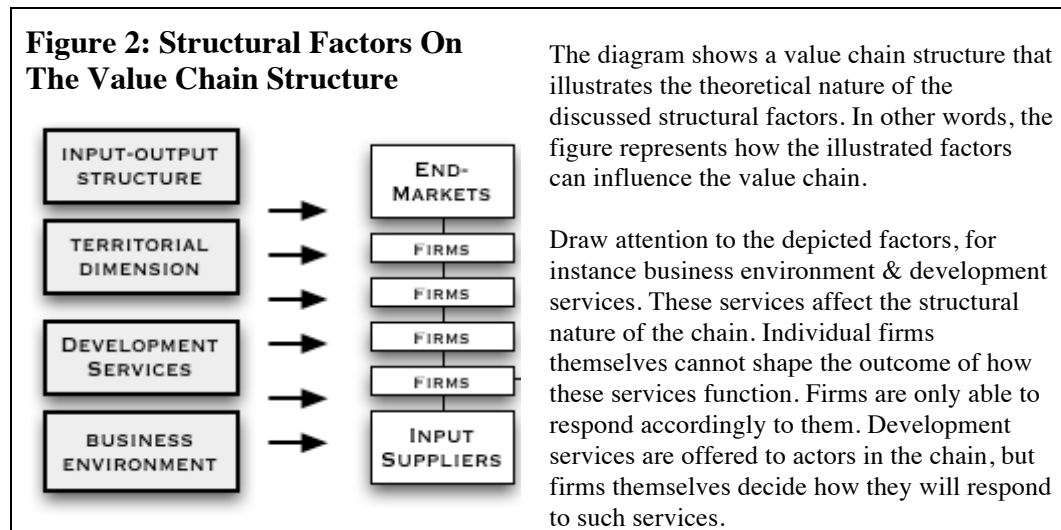
Three additional structural factors help assess the holistic nature of the chain (Campbell, 2008). Considering who the end markets are is important for determining the needs of the last actor who handles the commodity, i.e., the consumer. While retailers normally set the demands for the particular types of wine they wish to sell, it is often the consumer who sets the prioritization of the product. This is essential for adjusting the market demands of wine and in relation to upholding the safety standards of the product.

This leads us to the next factor: assessing the business environment. A stable and well functioning business environment is what allows small and large-scale firms to sustain their operations. Often times, such environments are determined by forms of governance that regulate a commodity or by how well the state is able to reduce threats and ensure safety, from for instance violence. Well suited business environments are also best approached by minimal government corruption and increased state transparency to the public. In essence, it is how well businesses feel the state supports their operations, by for instance, tax breaks or other privileges.

For commodities to be traded, local, national, and global laws generally apply to alcoholic products. These laws help protect and assess the norms, customs, regulations, policies, and trade agreements and other relevant attributes to mapping a value chain. For instance, assessing the international regulations of alcohol provides us with important determinants regarding not only who should be included in the chain, but also their role as well.

Lastly, development services for the production-based firms are essential for initiating and sustaining their operations. Banks, including microloans, and capital investments are needed for producers to start up their businesses. These third party structural actors play an essential role in understanding the links and nodes of the value chain.

Figure 2 is a visualization of the discussed structural factors and how they theoretically impact the value chain.



3.3 Dynamic Factors

As opposed to the structural factors, the dynamic factors are based on how firms and actors choose to compete on the basis of how the value chain is structured. It is thus first required to build the value chain based on the structural components and then secondly, analyze it based on how the actors are positioned within the chain and what they can do to mobilize stronger value. Alternatively, the dynamic factors can also be concerned in relation to why firms are not able to produce value.

3.3.1 Chain Upgrading and Downgrading

Firm upgrading is the act of improving and increasing the participation in the global economy by way of creating more value within the GVC (Giuliani, et al., 2005:2). Upgrading is linked to the process of improving the process of how commodities are made (Ponte & Ewert, 2009:1637). This applies to the scenario of small firms wishing to increase added value to the chain. In other words, when firms move vertically up the value chain, the firm is placed in a better functional position that allows them to invest more value to the finished product (Ponte, 2008:9). Firms can upgrade through several methods, the ultimate goal however is

to improve their competitive position in global value chains (Gereffi, et al., 2001:6).

Alternatively, downgrading can be applied when actors lose their vertical power. A commonly described scenario would include when the market share of an actor declines, when the unit price increases which hinders how much the actor can compete, and when cheaper goods are available that would push an actor down on the value chain (Moodley & Velia, 2002:5).

The most vertically dominant actors on the chain can also be described as chain drivers or lead firms. These are the most powerful actors in an industry that have the power to influence other participants in the GVC (Gereffi, G., 2001). For instance, an important part of global trade is conducted by chain drivers or through systems of governance that link firms together in a variety of sourcing and contracting arrangements (*Ibid.*, p. 2). Who is included and excluded for contracts within the chain is highly influenced by the largest chain drivers within the GCC.

Given the goal of firms to upgrade in the GVC, this inherently means that the actor creates value on the chain. Value can be defined as the total cost value that is added within the chain by each actor (*Ibid.*, p. 7). For example, South African wine selling at \$100 in England might break down into \$6 going to workers, \$9 to the contractor, \$22.50 for processing, \$12.50 for logistics, and \$50 to the retailer.⁸ The actor with the highest value added to the chain can presumably be described as the lead firm.

Higher value however is not necessarily defined as only creating more product value, but can be described within three other categories (*Ibid.*, p. 89). 1) Firms can reorganize to create more efficiency in commodity production, otherwise known as process upgrading. 2) Firms can modernize new methods of the functions required for commodity production, known as functional upgrading. 3) Intersectional upgrading is taking a 'best-practices' approach that gathers the strengths of other commodity productions in different sectors.

⁸ Example modified from Gereffi, et al., 2001.

An example of firm upgrading in particular is when retailers attempt to lead a chain by earning oligopolistic rents, dominated in three particular areas (Gibbon & Ponte, 2005:18): 1) sale prices 2) their own product brands 3) their relation to suppliers. These areas help bring firms into lead positions, while on the other hand, this also creates entry barriers which prevent non-lead firms from emerging (*Ibid.*, p. 32).

3.3.2 Value Chain Governance

The ideas behind value chains and the competitiveness of firms are seen in relation within the backdrop of governance. Understanding this and how firms can work around it becomes the foundation for firms in developing countries to improve their positions within the GVC, otherwise known as firm upgrading (*Ibid.*, p. 78). Defining governance can be thought of as "how certain firms set, measure, and enforce the parameters under which others in the chain operate (Humphrey and Schmitz 2002a, found in Gibbon & Ponte 2005:81)." As noted however, firms are not limited to actors within the chain (e.g. retailers or producers), but defining firms can also include all international trade regimes (e.g. WTO, bilateral trade agreements) that influence the participation or non-participation of such actors.

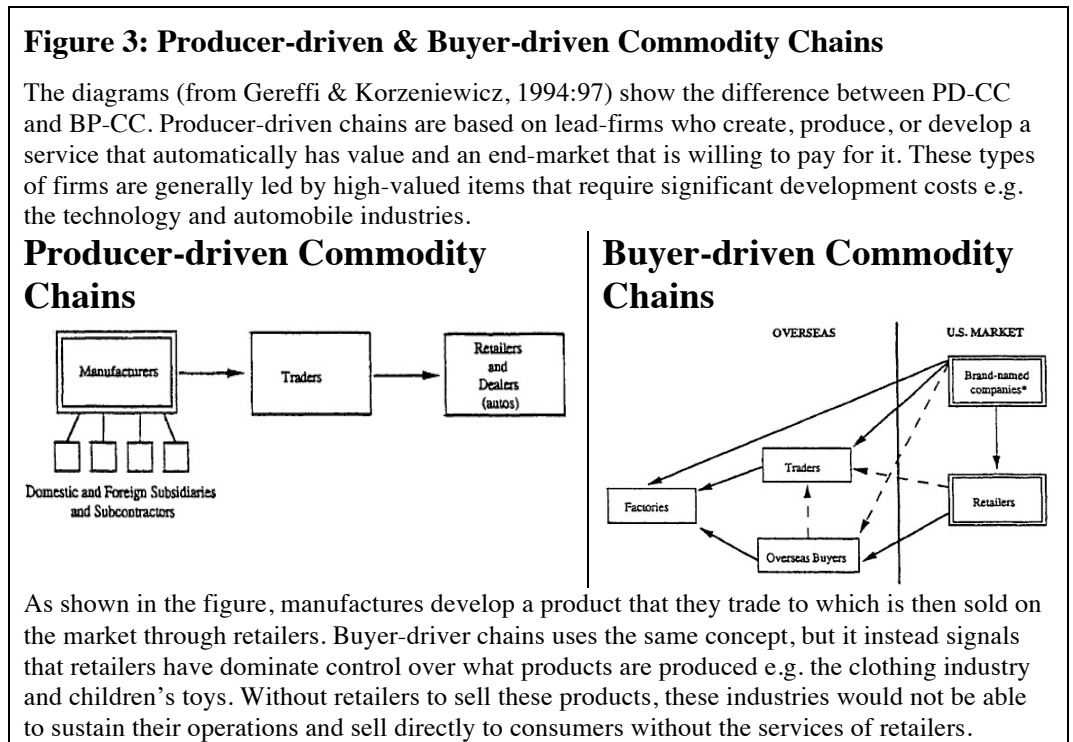
The General Agreement on Tariffs and Trade (GATT) and then later following, the World Trade Organization (WTO) were brought about to deal with tariffs and free-trade agreements during the push for global market liberalization (*Ibid.*, p. 35). While developed countries helped motivate economic globalization led by export-oriented economics, which also became part of deregulated markets, a new form of global regulation was instead occurring. Developed countries encouraged free trade does not imply that all trade restrictions are removed. Alternatively, Africa has had a history of being faced with trade barriers as a result of sanctions, which became obstacles to their own development. These

obstacles were created for those who could not maintain the standards dictated by the new agreements made during by members of the WTO.⁹

3.3.3 Producer Driven/ Buyer Driven Firms

A dichotomy of two other forms of governance exists within governance structures: "producer-driven" and "buyer-driven" commodity chains (see figure 3).

Producer driven chains are led by firms that distinguish themselves by working in high technological sectors with a high capital requirement. Buyer-driven chains are led by firms, e.g., retailers that sell what are made as generally labor intensive trades. The demands for what commodity is traded are primarily a result of the lead firms that dictate to low tier firms what is to be manufactured. The inclusion of firms in buyer-driven chains is often defined by lead firms or governance based institutions (Gibbon & Ponte, 2005:76).



High barriers of entry also characterize producer-driven chains (Gereffi, 1999:2). Start up costs and the high costs of investment generally act as one of the

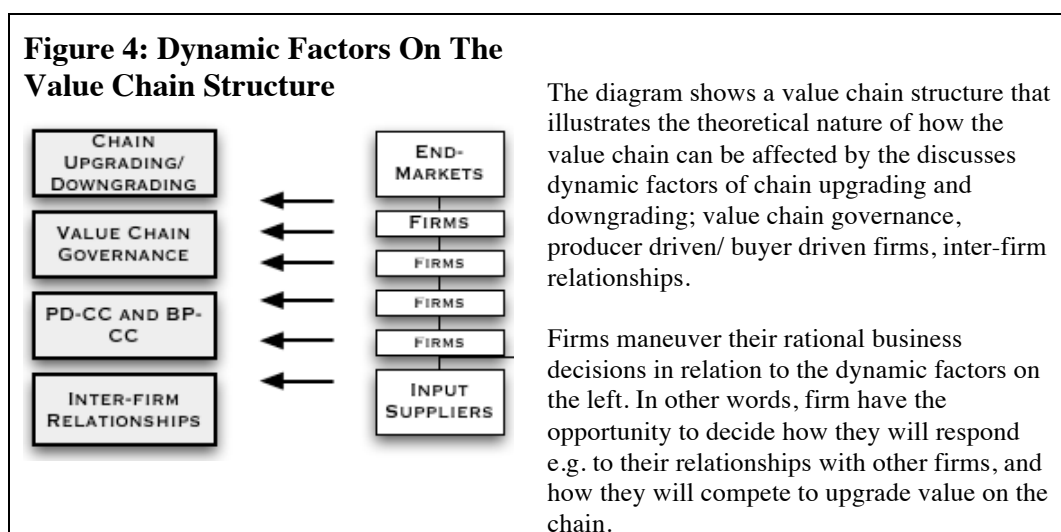
⁹ Examples of policies which act as a form of international governance include the agreements of: agriculture, textiles, intellectual property rights (TRIPs), investment (TRIMs), services (GATS) and sanitary standards (SPS) (Ibid., p. 53).

barriers that set apart buyer-driven chains. When firms themselves are able to financially support the research and development to produce and manufacture a commodity, they generally do not need to rely or depend on other third party firms or services to help support the costs of developing the commodity. Such a case is not seen in African-based wine. Wine producing firms instead often rely on the earlier discussed end markets, business environment and development services to support their operations to produce a wine that the end-market demands.

3.3.4 Inter-firm Relationships

As noted from the discussion on vertical and horizontal linkages, well formed and managed relationships create the success of being able to send and receive trade flows from the bottom-end of the chain of the production process to the end market. The relationships between firms in the value chain must also be noted for the analysis. Without proper cooperation, there can be no resource pooling. Producers are limited in their decision making power when they are small in operational size. If producers however pool their resources, they are more able to sell their trade upwards in the chain. This can help upgrade their value within the chain.

The following figure depicts how individual firms can influence the theoretical dynamic factors.



3.4 Chain Inclusion and Exclusion

Within the development literature, there has been a clear lack of assessing the relationship between those who are excluded from value chains and their relationship with poverty. This omission has been heavily highlighted by Du Toit, where he found that disregarding this relationship within the globalization process often resulted in failure of capturing how impoverishment is elevated due to the failure of actors in being able to integrate into broad social and economic networks (du Toit, 2004:987).

Exclusion of this form can be defined as those who are discriminated and excluded from social and economic processes (*Ibid.*, p. 989). This definition escapes the narrow definition of monetary value, household income or GDP, and instead takes a multidimensional view of exclusion and the institutional processes that hinder or influence it (*Ibid.*, p. 989).

However exclusion does not carry a universal definition, but rather is used to describe the context of a firm being outside an institutional sphere: e.g. economic, political, social spheres. Exclusion has shown to have detrimental effects on civil society. This is evident when stratifying South Africa's civil society and taking into account that the wealthiest 12% of households have held 45% of the total household income (*Ibid.*, p. 990). 41% of South African society however is comprised of the working poor and constantly unemployed, who combined earn only 10% of the country's income (*Ibid.*, p. 990). Considering these inequalities, it is worth assessing if integration within the commodity chain can reduce poverty for marginalized people.

Inclusion however assesses the relationship between actors who are included within an economic sector and whether poverty has increased or decreased. In the theoretical sense, integration is not limited to a particular sector; it can be either agriculture, industrial, or service. Where actors can integrate in the value chain is best determined by knowing their comparative advantage; eg what services they are best able to work in.

3.5 Moving Forward: Operationalizing the Framework

By way of conclusion to the theoretical foundation of this study, I will now recapitulate the applied concepts, which will then be followed by operational definitions to the indicators that will be applied when assessing the included and excluded firms of this study.

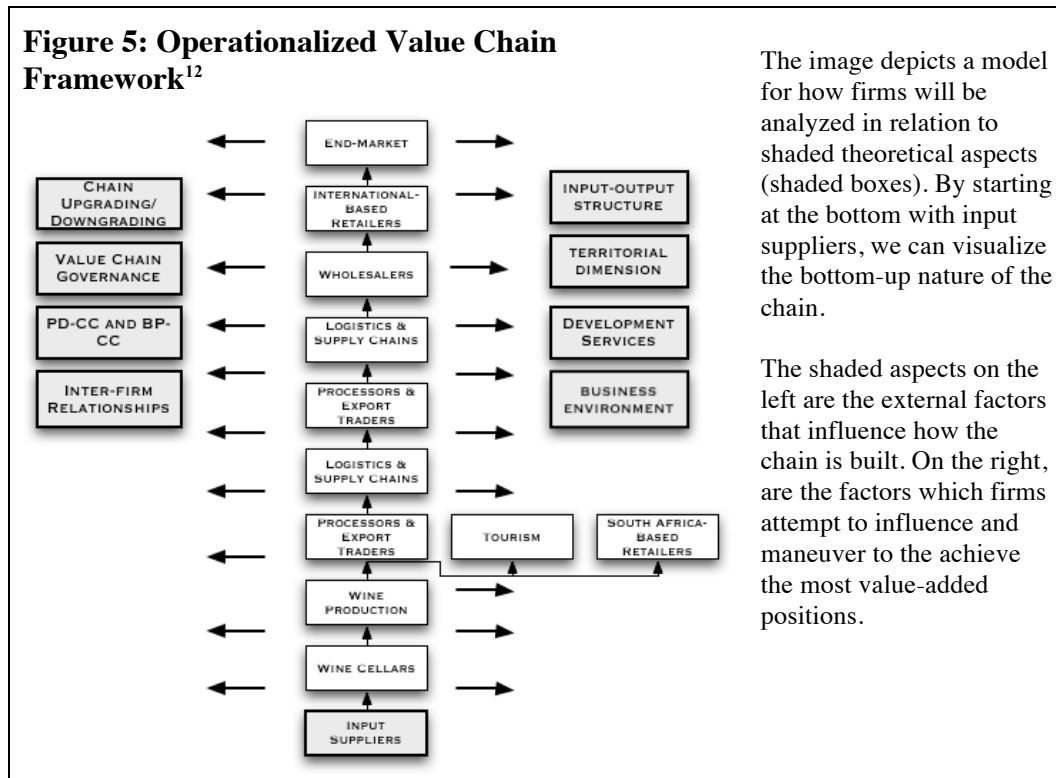
Global Value Chains are an approach to describing the process and stages and handling that is required of a commodity, from production to consumer.¹⁰ *Structural Factors* place and specify where certain actors are located within the chain.¹¹ These factors include Gereffi's dimensions: 1) the *input-output structure*, which is the sequence of which actors create value to the commodity. 2) *Territoriality dimensions* places the actors within a geographical scope of domestic or global. Assessing the vertical and horizontal is also essential. *Vertical analysis* looks at the relations between actors in their goal for product productivity and moving their added value upwards to the global market. *Horizontal analysis* instead considers the small-scale actors and those excluded from the chain. *End Markets* consider the needs of the consumer and understanding the *business environment* considers how for instance, the state and other regulatory actors influence who can be included in the value chain. Lastly, *development services* consider the importance that external banks, investments, and loans can offer to small-scale firms and their integration into the value chain.

Dynamic factors alternatively, are factors that are rationalized by firms as a way to maneuver their way into a value added position. Assessing this is based on 1) how firms can *upgrade* to a value added position, while asking why other firms inevitably *downgrade* to a lower value added position. 2) The *governance* of who and what acts through power over an actor. This includes *producer-driven firms* that lead the production of a commodity by high capital investment, while *buyer-driven firms* instead can be retailers who set the demands from what they want to sell. Finally, *inter-firm relationships* assess the linkages of actors in the chain, based either on cooperation and resource pooling.

¹⁰ Refer to section 3.1, *Global Value Chains*.

¹¹ Refer to section 3.1.1, *Structural Factors*.

These factors are then analyzed in relation to the actors who are *included and excluded* from the chain, and how such a chain goes on to further influence or reduce *poverty reduction*. Figure 5, *Operationalized Value Chain Framework*, illustrates the theoretical nature of the discussed structural and dynamic factors in relation to the actors in the value chain.



Indicators (or operational definitions) are needed to best be able to apply a firm into the value chain. The indicators will be used to define actors and act as a tool to construct the value chain. The firms that are included in the value chain analysis will be included on the basis if they meet the following operational definitions. These firms have been included on the basis that they carry most relative influence on the winemaking process, from start to finish. A review of the literature has also led me to the following ten firms as the most important and influential for linking together the chain.

¹² Source: Kaeraa, Marc Falcon. (2011) *Linking Up The Value Chain: Assessing The Inter-Firm Linkages That Make Up The International Global Value Chains Of South African Wine And Its Effect On Pro-Poor Economic Growth*. Lund: Lund University.

Input suppliers: include a number of services that are mainly agricultural in nature. Services include the harvesting process and developing soil and plant material for growing grapes used for winemaking.

Wine cellars: services specializing in storing wine for the purpose of ageing and improving e.g. flavor, aroma and texture.

Wine production: The process of taking a finished wine, in its liquid form, and packaging it, followed by taking a consumer-marketing approach to attract consumers to the physical bottle.

Tourism: Firms responsible for where consumers can tour vineyards, wineries, or other related events for the purpose of tasting or consuming wine.

South Africa-based retailers: South African retailers who stock and offer a selection of South African wine.

Processors and export traders: Services that take the principle role in exporting South African-based wines.

Logistics and supply chains: Services responsible for shipping wine from its origin to the final retailer or consumer.

Wholesalers: A branch of the industry that helps retailers purchase wine stocks directly from the wholesaler, instead of from wine producers and then continues the sale process closer to the end-market.

International-based retailers: Firms located abroad that sell wine directly to their local consumers.

End market: The final set of actors that handle wine for private consumption; the consumers.

The described value chain framework is just that, a framework. It is a guide to approach the study of how the production of a commodity shifts from one actor to the next and beyond. This is not meant to imply that such a framework will consistently describe reality in the same context of the wine industry. With this in mind, defining certain actors, for instance the input suppliers, may be much more complex. Different actors in the value chain framework may need to be

broken down to best depict how the process of commodity handling works in practice.

4. Setting the Stage: The Backdrop Behind The Industry

This section will help provide a backdrop to the industry as a way to best create a foundation for analyzing the value chain of wine in South Africa. Since the beginning of South Africa's post-apartheid history, government led policies have attempted to implement land distribution policies as a measure to reduce the racial inequalities of land ownership. If the black populations of today are not able to own land due to the apartheid era policies of the past that kept the white populations as the principal owners of all land, there is then little chance for today's primary-based production firms to upgrade their added-value into the chain. In order to see how much value is added, this section will also look at macro-economic data and discuss the economic distribution of value throughout ten services of the chain. The ultimate goal is for firms to increase their added value to the chain, which will help upgrade their position in the chain to become chain drivers. When small firms increase their value, the threat for impoverishment is reduced among low-income households. Pro-poor growth by increasing the incomes of the poor will be discussed in relation to the state's policy-based strategies and will look at how it affects the value-chain. But before jumping into these issues, let's briefly first look at recent research on the topic of the value chains of wine in South Africa.

4.1 Building on Past Research: What Has Been Said?

Previous studies on South Africa's wine sector in relation to global value chains have been limited. However, by reviewing relevant literature and pulling it together, there have been some notable studies that have helped introduce the complexities that actors face within the chain. Looking at the work that has been previously made regarding the value chains of wine helps to not repeat the same research, but also helps act as a guide to knowing what is already known and what research is missing in the field.

Thus this thesis also takes current knowledge on the value chains of wine in South Africa as a starting point for knowing what wine-relevant research is lacking (and the introduced thesis questions discussed in the problem field). Ponte (2009) provides an insightful look at how firms who wish to upgrade their value are limited by global quality conventions of wine. While global retailers demand basic quality South African Wine, this results in producers offering low flexibility, low margins, and little incentive to upgrade the class of their wine (Ponte, 2009:252). His work however doesn't map out firms within a chain, but rather focuses more on discussing the determinants that restrict upward mobility and firm upgrading.

Ponte continues his research on the governance of wine with focus on how specific structures within the industry are manifested by lead firms (*Ibid.*, p. 45). He discusses how lead firms such as retailers are able to influence the popularity of wine based on retail promotion and media. He takes a lead firm perspective to discuss why barriers of entry exist for small-scale firms. UK retailers, which also account for a majority of South African wine sales have a power relation over other firms by demanding particular packaging, upholding food safety standards, and the logistics needed for placing the wine on the retailers shelves (*Ibid.*, p. 22).

Another study (Meissenheimer, et al., 2001) provides an interesting insight describing the main actors that most determine and impact the future of South Africa's wine industry. They report on the importance of how cooperation of firms can best allow the sector to compete in the international market. However a reputable international image, with support from a stable political environment is also critical (*Ibid.*, p. 41). The report additionally makes the conclusion that the factors needed for a competitive and value based wine sector are indeed present in South Africa: natural resources, wine ecology, and research and development.

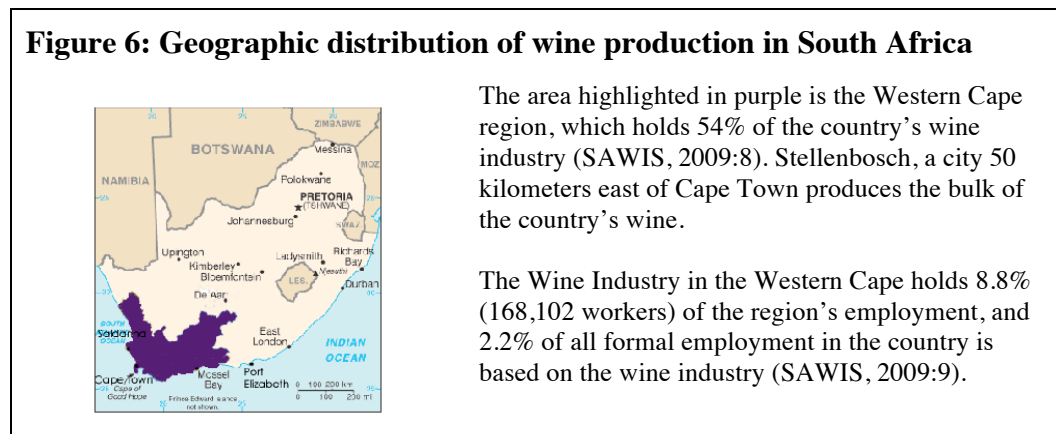
The South African-based, National Agricultural Marketing Council (NAMC) launched their report with an investigation on the structural changes and liberalization of the post-apartheid economy and as a result, the launch of a new strategy for growth as a wine competitor in the global economy (NAMC, 2002:iii). The wine harvests are increasingly becoming a major attribute for

quality improvement and an increase in wine exports. This has resulted in significant investments made in the sector by both foreign and domestic sources. Alternatively from the Ponte (2009) study, the NAMC reports how quality incentives are increasing the production of quality grapes.

South Africa’s wine industry has met important developments since the early 1990’s to the mid 2000’s. This is particularly important for South Africa, but if the industry cannot sustain its development or produce efficiently, the consequence will mean a reduction in exports and sales abroad. To put perspective on this and by way of introducing the macro-economic landscape of South Africa’s wine industry, I will now provide an overview of its industry’s impact on the country’s GDP and employment.

4.2 The Macro-Economic Landscape: Who is Getting How Much?

Before we can analyze a value chain, we first have to look at data to find where value is placed. The following macro-economic data will provide an overview of South Africa’s wine industry. Most data that has been charted into graphs was gathered from the South African Wine Industry Statistics (SAWIS) or other sources where noted.

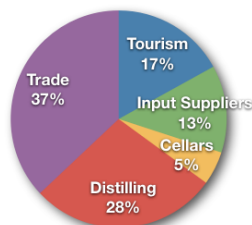


The industry holds formal employment for 275,606 South Africans and in 2008, contributed 2.2% of South Africa’s GDP (SAWIS, 2009:9). This makes the South African wine industry the worlds 8th largest wine industry by measuring total wine volume, producing between 800 and 900 million liters of wine (Bruwer,

2003:424). South Africa's wine industry can be measured as producing half the size of Australia's wine production and 60% of Chile's (Bruwer, 2003:424).

The industry in 2008 added R26,223 million (\$3,9 billion USD) to the general economy from direct, indirect, and induced services that support the industry. R14,214 million (\$2,1 billion USD) of that went to the Western Cape (as seen on map on figure 6), equaling 7.3% of the provincial economy's GDP. Input suppliers saw an increase from R2,406 million (\$360 million USD) earned turnover in 2003 to R3,320 million (\$500 million USD) in 2008, an increase of 38%.

Figure 7: Percentages of value chain GDP contributed by South African wine services



The figure shows the economic contributions that wine-based services in South African have made to the country's GDP. The percentages shown are the percentage of the wine industry as a whole. Attention should be made at how trade generates nearly 2/5s of South African wine sector GDP.

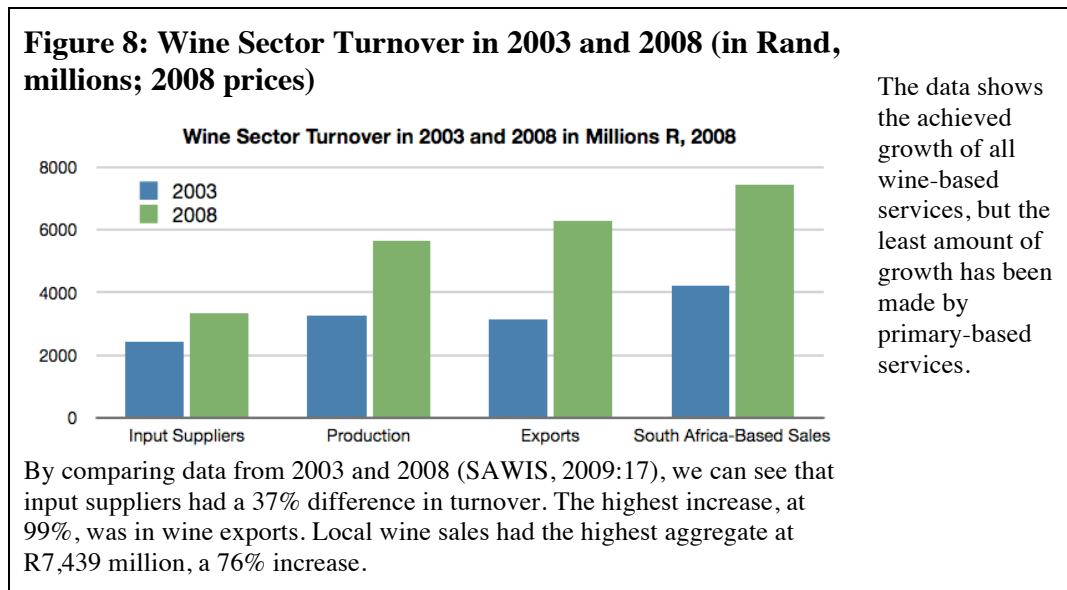
The data presented in figure 7 tells us that 2/5s of the wine industry's GDP to the country is based on trading wine abroad. This illustrates the positive result of ending trade sanctions against South African after apartheid. But criticizing this assessment may however show us that it is not purely the export process that generates increased value. Instead, South African-based firms could also work the same high value services, but the value chain structure is what prohibits South African firms creating the value that exporters add.

The wine industry's economic turnover for all sectors (see figure 8 on the following page) in South Africa totaled R19,164 million (\$2.8 billion USD) in 2008.¹³ R6,272 million (\$929 million USD) was made directly from exports. The industry generates R17,124 million (\$2.5 billion USD) of disposable income for private spending among its employees. Low income (poor) households made up 17% of disposable income earners in the industry (SAWIS, 2009:9).

¹³ R19,164 million includes sectors not labeled in the figure.

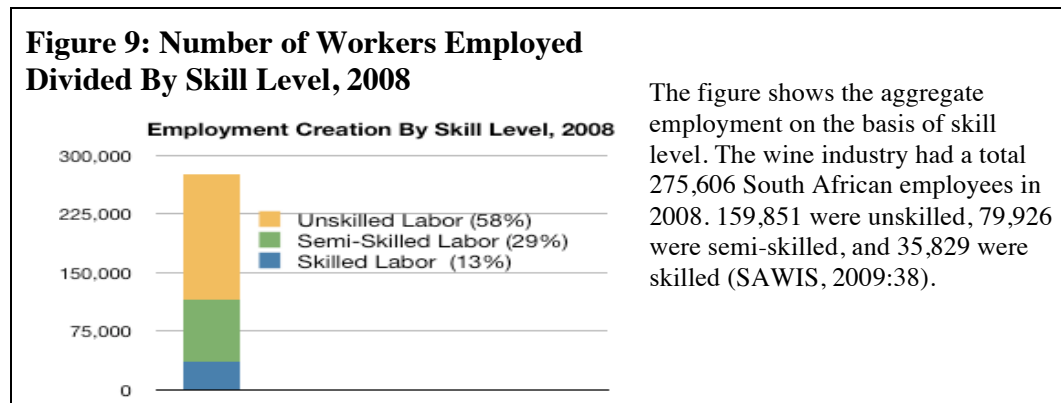
The statistics regarding how many people work within each service of the wine chain are mixed. In 2003, SAWIS (2004) calculated the industry as having employed almost 3,500 cellar employees, 345,000 non-permanent (seasonal) workers, with 104,000 farm workers. The Wines of South Africa (WOSA, 2004) calculated a total of 348,000 employees working either directly or indirectly in the wine industry, which includes farm workers, production, and retailing. Included are also 48,350 people who are employed in the country’s wine industry (Tassiopoulos, et al., 2004:52).

Production saw an increase from R3,274 million (\$485 million USD) in 2003 to R5,644 million (\$836 million USD) in 2008, an increase of 72%. Similar increases during the same time frame were also found in other sectors: exports rose from 3,153 to 6,272 (99% increase) and South Africa-based retail sales jumped from 4,223 to 7,439 (76% increase).



One observation we can take from looking at wine sector financial turnover statistics from the figure above is that there seems to be an apparent trend that those firms and services that work further away from the winemaking process are also the services that create most value to wine. The firms who add more value to wine are those who work with the product after the initial winemaking stages; i.e., after input suppliers handle it. If we consider this point and since we know that input suppliers receive the least turnover from a finished bottle of wine (refer

to figure above), we can deduce the question: are the low valued services also the services where low-skilled laborers are found? Valid data for studying this relationship is unfortunately not available, but the data regarding the number of laborers employed categorized by their skill level has been calculated by SAWIS (see figure 9). Nearly three-fifths of all employment is occupied by unskilled workers and skilled workers hold less than one-fifth of employment labor.



What does the collection of this data tell us? To a large extent, wine production in the country is limited to a central wine-producing region: the Western Cape. More than half the country's wine is produced in this area. Factors for why the industry is not distributed to the rest of the country will be further discussed later, but explanations include that wineries and vineyards are non-existent in remote parts of the country; land owners are not motivated to enter the wine industry and thus do not extend wine production to other parts of the country; and it is difficult to sustain nutritious and fertile soils for wine-making in other regions.

Nonetheless, by comparing data from 2003 and 2008, we can see that all services (for which data is available; refer back to figure 8) have seen a rise in returned revenue. However there are apparent inequalities of what services are receiving most relative revenue compared to other services. Input-suppliers and firms working in the primary-production process receive nearly half of the economic turnover compared to the turnover received by export traders and retailers. This is also in line with looking at what South African-based services are adding most value to the value chain's GDP; traders take a majority of the relative

pie. Input suppliers and cellars on the other hand contribute the least added-value to the chain.

4.3 Land Distribution: Post-Apartheid Reconciliation?

When the apartheid-based policies of state-sponsored discrimination ended in 1994 with the leadership of Nelson Mandela and the African National Congress (ANC), the party's ideas and intentions were focused and clear: to replace the decades of racist and exclusionary policies against the non-white populations and instead promote and legally amend freedom for blacks and all populations in the country. But how well of an effect have the ANC's policies had on mainstreaming the excluded non-white populations into society and economic structures? Are the non-white populations still socially and economically marginalized in post-apartheid South Africa?

It is clear that if the black populations cannot purchase and own farmland, they will never be able to upgrade their value position in the agricultural sector and in particular, the value chain of wine. One policy in particular that the ANC sought to establish was the free determination of blacks to own land. Pre-1994 South Africa restricted land ownership and land rights to the non-white population; only 13% of the country's farmlands were allocated to the general black populations (Rugege, 2004:1). These areas were mainly degraded, had poor soil fertility, and they were prohibited from owning land in the province holding the vast majority of vineyards: the Western Cape. The obvious result of land restriction meant that whites held complete decision-making power of land use and production. Preventing black populations from owning land during apartheid has become a legacy that in some respects is still observed in today's wine industry.

Post-Apartheid South Africa has implemented land reform and distribution programs intending to help the black and coloured populations acquire land if they were originally unqualified for land restitution. But these programs have all had varying success. Qualified recipients of government programs were granted with a little over R21,000 (\$3,000 USD) to purchase agricultural farmland (Moseley,

2007:18). This approach generally ended in either one of two ways: individuals pooled their grant money to purchase land or individuals entered into partnerships with a white wine farmer (*Ibid.*, p. 19).

Purchasing farmland is relatively expensive and in most cases the granted money given for land purchases does not meet the asking price of land. In these cases, it is common for groups of 50 to 100 people to put their grants together to meet the total sale price of land (*Ibid.*, p. 18).

As a second option, through what is known as 'shared equity', grant recipients can use their grant to purchase a percentage of a farm that is already in use. Whites are in most cases the principal owners of these farms and the black grant recipient works as a partner on the farm, for that particular percentage of farmland that was purchased.

But these two approaches for land distribution still leave the black populations without owning their own vineyards, because of two explanations (*Ibid.*, p. 18). Vineyards are expensive and far out of reach unless thousands of people pool their resources for a single vineyard. Secondly, the benefits of cooperating with a white farmer who has experience and contacts within the value-chain will help sustain a greater success rate than otherwise being part of a collective farm that have never experienced the winemaking process.

The ANC has responded to the difficulties of the formerly excluded during the apartheid era and their difficulties in mainstreaming their inclusion and purchasing land. The ANC has launched a land reform program to transfer land from the whites to the non-white populations by 2014 (*Ibid.*, p. 16). The program intends to redistribute 30% of all primary commodity-based farmlands as a method that will not only allow black owned businesses to operate and develop, but it will also increase the inclusion of non-whites in the mainstream decision-making process.

One need not look further than the Western Cape to assess if the program is working. If land reform is not implemented in the areas that would potentially create the most added-value for any given commodity, the program will then have little influence on including actors to the value-chain of wine, or any value-chain

for that matter. The white populations for most of South Africa's history have historically always dominated the Western Cape. The province itself has not yet escaped its white ruled historical past – and it's present.

4.4 Pro-Poor Economic Growth As An Approach To Poverty Reduction

Pro-poor growth is commonly described in the development literature along the lines of creating the opportunity to allow the poor to create and increase economic growth within their households. Economic growth among the poor then becomes a strategy for poverty reduction. Poverty reduction is another term that is commonly applied in the development literature as a theoretical concept to analyze and a strategy to critique. For the purposes of this thesis, pro-poor growth will be applied through the perspective that it is an approach that is influenced by the value chain's growth, which is led by post-apartheid economic restructuring and wine exports.

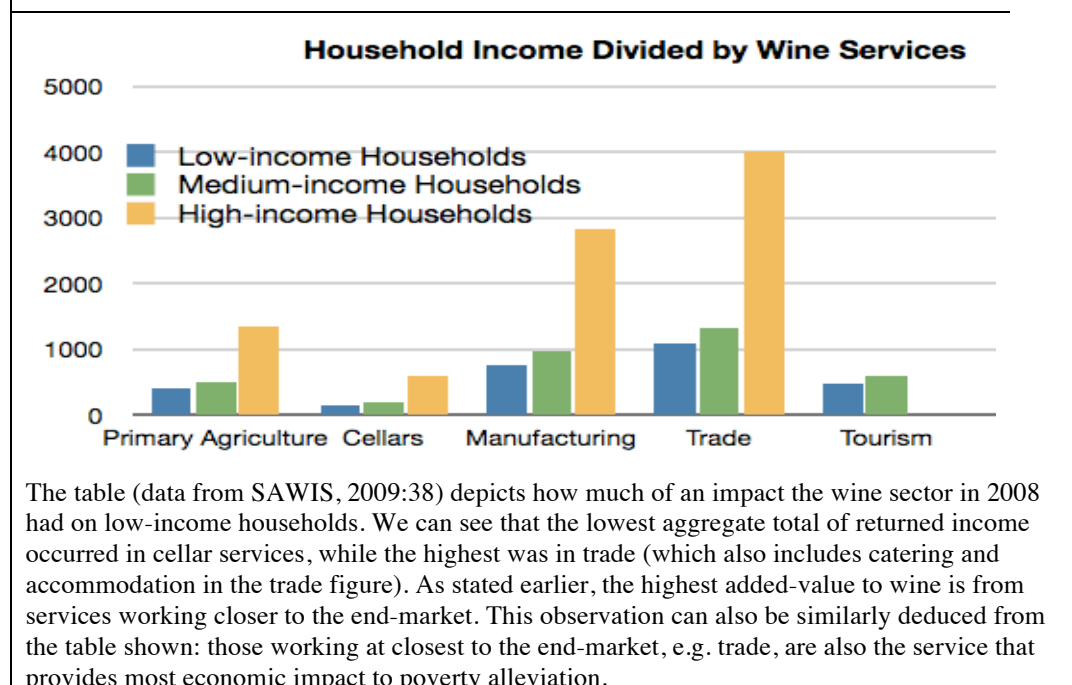
Pro-poor growth is particularly relevant to the discussion on the value chain of wine when considering that a large portion of incomes to sustain the livelihoods of rural households come from agricultural-based activities (Kydd, J. et al. 2004:3). Pro-poor growth is a central element in poverty reduction by way of economic empowerment among poor individuals and households. Achieving economic growth among poor households is a contributing factor to help escape poverty. One of the central definitions to pro-poor growth can be defined as poor households achieving a higher rate of income (Kraay, 2004:198).

But the usage of 'poor' in reference to low-income households has also been critiqued. Du Toit questions the relative notion of poor and discusses how the concept of 'poor' is applied too broadly and that when South Africans speak of the poor, they speak instead in relative terms that describe how poor someone is: the 'almost poor', the 'all-but-poor', and the 'not-so-poor' and one other category should also be noticed, 'poorest of the poor' (du Toit, 2004:991). This exemplifies that when dealing with poverty-stricken countries, measuring populations as being poor and middle-income creates a false dichotomy between two choices; they are neither 'poor' nor 'medium-income' because their economic income is not within

those two categories. Post-apartheid democracy has empowered all categories except for the latter (*Ibid.*, p. 991). These marginalized 'poorest of the poor' are poor not only because of their low working wages and landlessness, but also their relative exclusion from the formal economy and their political marginality (*Ibid.*, p. 991).

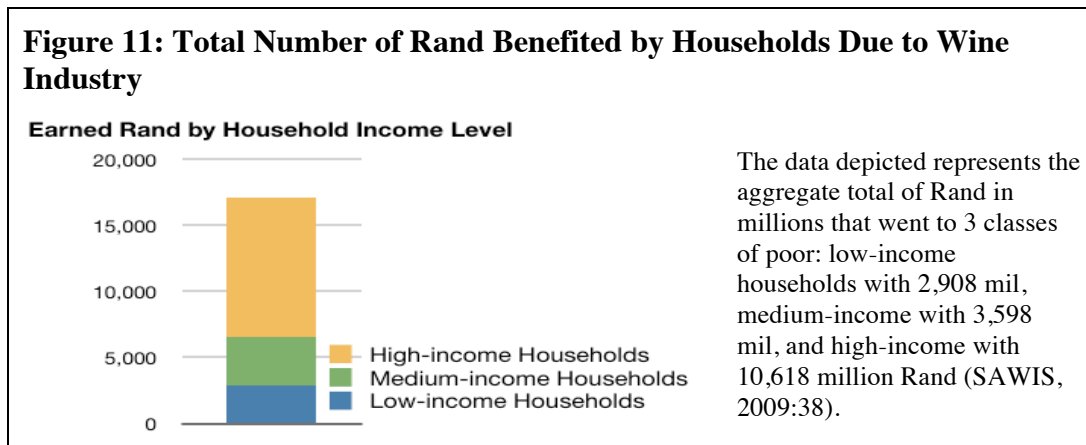
In studying economic growth among the poor, one of the central elements of many South African macro-economic assessments is to determine the impact that growth has had on poverty reduction (SAWIS, 2009:38). Assessing poverty reduction in relation to South Africa's wine industry and value chains can be determined by looking at if the poor are benefitting from the value chain and how much of an economic impact has been made to low-income (poor) households. The below figure 10 visualizes this discussion: here we can see the extent to which the South African wine industry has brought pro-poor economic growth to household incomes.

Figure 10: Economic Growth by South African Households Divided by Wine Service (in Rand, millions; 2008 prices)



When looking at the data regarding how much revenue from the wine industry is going back to the poor, it is evident that the poorest share the lowest

totals, while the higher income households have benefited more by the wine industry. This is further exemplified when looking at the aggregate totals of Rand that different household income levels receive (see figure 11).



Although we can see that low-income households have received the lowest returns, looking at how much Rand is returned to the households of what income groups is essential for assessing how much of an effect the value chains of wine has had on pro-poor economic growth. Although the returns received are on the basis of the wine chain, state-led policies in the backdrop of the wine industry have influenced how the industry runs within the South African economy. In the pursuit of alleviating poverty and enhancing sustainable economic development and growth in South Africa as well as other governments in Sub-Saharan Africa, policies have been introduced over the years to different forms of pro-poor development strategies: either by way of their own government policies or by becoming ‘recipients’ of poverty reduction strategies by international organizations.

During the 1980’s and 90’s, the World Bank (WB) and the International Monetary Fund (IMF) were one of the first to advocate that poor countries should implement structural adjustment programs (SAP). The purpose of structural programs was to integrate developing countries into the global economy by promoting exports, reducing state activity, and liberalizing trade, investment, and finance, which in the WB and IMF’s perspective, also reduce poverty.

A decade later, poverty reduction strategies papers (PRSP) became the central policy instrument to address pro-poor growth in many developing countries through intervention in four priority areas: (1) macroeconomic stability and structural policies to support economic growth, (2) social policies and programs to address human capital (in particular its education and health-related attributes), (3) infrastructure development, and (4) good governance and healthy institutions. These reports are authored in cooperation by both the World Bank/IMF and the national country. Some countries however that are not considered highly indebted, including South Africa, still write Poverty Reduction Strategies (PRS).

Post-apartheid South Africa has initiated five PRS'.¹⁴ These strategies have suggested varying approaches to addressing poverty. The country is challenged with high level of illiteracy, low standard of living and poor health and environmental conditions. Making macro-economic adjustments to revive the economy has been one particular strategy to boost economic returns among the poor, which is an approach that goes interestingly with this thesis in applying value chains. The state however has not released official recommendations regarding if previous macro-economic adjustments are at fault for continued economic disadvantages among the country's populations.

Public debates in South Africa regarding pro-poor growth strategies have instead highlighted marginalization as a factor for poverty in South Africa, which has been influenced by the country's tangled history of tense social relations. Even though South Africa's post-apartheid history has brought an end to state enforced racism, today's South Africa is still reminiscent of its past in consideration of three particular aspects.

First, South Africa still carries a paternalist legacy characterized by slavery and colonialism. White men have been the dominant figures to hold an elitist status and owning land has historically during apartheid depended on the

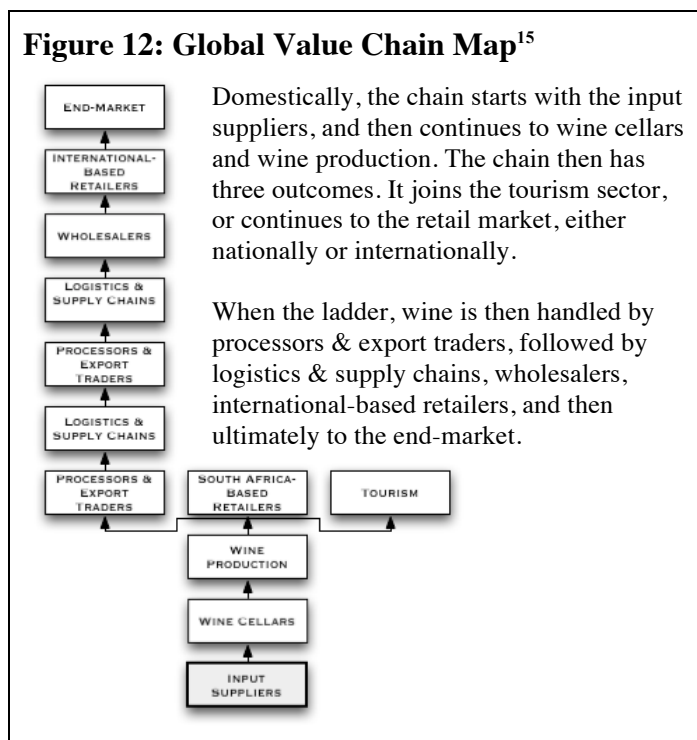
¹⁴ The five poverty reduction strategies are: Reconstruction and Development Programme (RDP 1994); Growth, Employment and Redistribution (GEAR 1996); Integrated Sustainable Rural Development Strategy (ISRDS, 2000); Urban Renewal Programme (URP, 2000); Accelerated and Shared Growth Initiative of South Africa (ASGISA, 2006).

slaved black laborers and indentured servants (du Toit, 2004:993). Secondly, during the current times of post-apartheid, the authoritarian, inegalitarian and racist tendencies of the past are still dominant issues of today that even though have been legally amended, socially it still remains among the country's older generations (*Ibid.*, p. 993).

Finally, after the collapse of apartheid, deregulation and economic privatization was taking place within the global backdrop of globalization and agro-food restructuring. The wine and fruit sectors experienced new forms of competitiveness led by private investors that influenced markets to transition from producer-driven to buyer-driven. Buyer-driven markets and firms created a shift for where most value in the commodity chain was created: firms working closest to reaching the end markets (e.g. consumers) became the drivers that led the production.

5. Mapping It Out: Building the global value chains of wine

Based on the operational definitions discussed in section 3 and the methods described in section 2, the following value chain map characterizes the production process of South Africa's wine industry. The following actors represent the domestic and international actors of the value chain (see figure below).



5.1 Input Suppliers

104,179 hectares of land are used for growing wine grapes (SAWIS, 2000). The input suppliers that service these acres work under several services, including developing and collecting soil and plant materials and general viticulture practices. While these services are

truly essential for wine production, little revenue and value towards the final product is added. These firms are placed on the lowest end of the value chain and primarily only have access to local markets to trade for essential materials needed to help safeguard maximum grape output. Grape production produces less added-value than every other part of the supply chain (NAMC, 2002:20).

Successful grape output is attributed to the nutrients needed for the soils which help grapes grow continuously. South African grapes are not exported to other wine producing countries for the intention of making wine abroad with

¹⁵ Source: Kaeraa, Marc Falcon. (2011) *Linking Up The Value Chain: Assessing The Inter-Firm Linkages That Make Up The International Global Value Chains Of South African Wine And Its Effect On Pro-Poor Economic Growth*. Lund: Lund University.

South African grapes (in some instances though grapes are exported for non-wine juices). Thus as a consequence, the market access needed for input suppliers to break through local barriers and into international markets is low and in most cases impossible.

This dilemma also significantly reduces the possibility of *firm upgrading*.¹⁶ Firms are not required to reach international markets to upgrade, but the fact remains that other actors in the supply chain are able to maneuver and exert power over the input suppliers and cast demands over certain requirements in determining what grapes can be traded and under what requirements they may be traded under. This situation leaves input suppliers under a strict form of buyer-driven production and value chain *governance*. Under the auspices of multilateral and domestic agreements, certain regulations are also at the core to explaining the limited nature for input suppliers to upgrade and create increased value for their essential services.

Input suppliers are also challenged by *business environments* that make entering the market a legally difficult process. National and international laws defend certain provisions regarding the production of alcohol. This is equally true for the agreements that were made to help ensure and safeguard certain qualities of wine. The complexities of wine grading come from many factors. As a particular example, input suppliers must abide by regulations that control the quality of grapes for the production of wine. When input suppliers are not able to meet these regulations, grapes inevitably become wasted or thrown away and the intention of delivering them for sale is never actualized. Input suppliers are very limited in their own power to execute or outmaneuver from such a situation. They are not able to lobby for certain quality regulations that would be most convenient for them and they are most often left out of the decision-making process for determining the grape criteria used in wine.

Given the mostly powerless nature of input suppliers, their existence is heavily relied upon certain third party actors, which enable input suppliers to stay

¹⁶ Theoretical keywords are in italics to help provide clarity and a more streamlined approach of understanding the analysis.

in business despite their market difficulties. *Development services* assist input suppliers in competing in local markets with small-scale firms integrating to the supply chain. Assistance can be provided to support the basic wine producing industry, while loans may be given for production costs and higher range capital investments to those contributing with basic viticulture practices.

Input suppliers are also the workers who have historically and presently lived and worked in grim conditions and backbreaking labor for poor wages. Half of the laborers surveyed in 1996 earned less than R18,000 per year and a third of those earned less than R1,000 per month (du Toit, 2004:992).

By considering aspects of *horizontal power*, we can see how chain exclusion is evident for some primary agricultural producers who still have not entered the chain as an input supplier. Entrance to the market as an input supplier can be characterized as rather exclusive. This is based on a historical nature where families were the principle owners of wine farms and new entrants have faced barriers of entrance, e.g. they don't have the land needed to enter the market. Families have on average owned their farms for roughly 80 years (NAMC, 2002:15). Since open trade in 1997, families have been shown to be the market leaders in driving wine farming, and not new firm entrants in the industry (*Ibid.*, p. 16).

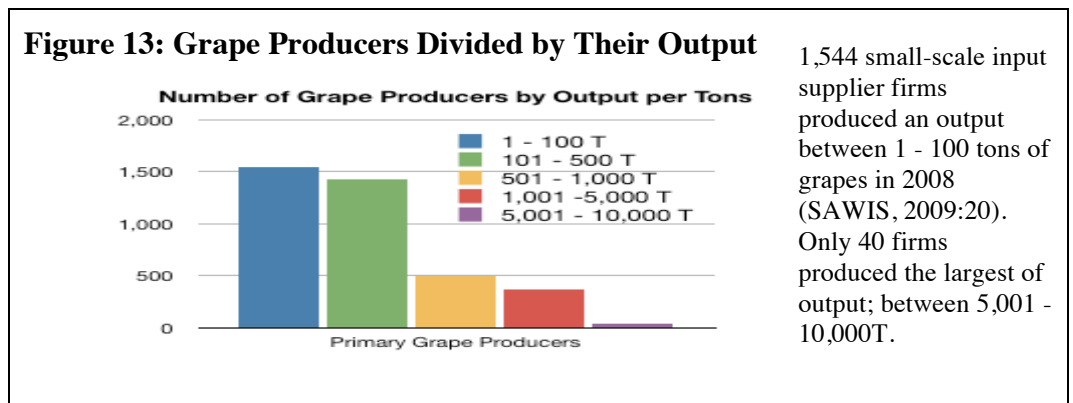
Input Suppliers are also part of an essential discussion regarding general South African agricultural policy. Input suppliers are working under a law-based *business environment* with state policy that has been set up to achieve three main objectives (*Ibid.*, p. 18): 1) Work towards mitigating the social and economic inequalities that were based on pre-1994 apartheid policies. A policy entitled 'The Restitution Programme' has attempted to act as an instrument for land reform to offset the unequal balance of wine farming families owning virtually all farmlands. 2) State policy has enacted the Redistribution and Tenure Security Programs and Land Bank and the Agricultural Research Council to ware off income equality over the industry, and in particular, input suppliers. 3) To increase the international competitiveness of the industry. Practically all government led policies have unanimously supported deregulation of the entire

South African economy and within the wine market. This also includes abolition of input and product subsidies.

The South African state’s concern is that they don’t want to interfere in the market, but to help rural and emerging commercial activities, the state has scaled up programs to help with entering the agricultural supply chain. The Land Bank’s ‘Step-up programme’, is in essence, a microfinance arrangement to help small-scale farmers and co-operatives enter the market.

Another program, led by the National Agricultural Marketing Council, has its principle task with helping entrants facilitate access to the supply chain within the farming sector. The Water Act helps give preferential access to water for irrigation for the needs of small-scale farmers.

The figure below leads to a similar point made earlier that we can deduce: that because input suppliers add the least value to wine, this means that they receive the least in return and are thus unable to make the required investments to boost their output because they are unable to create economies of scale. We can see this by looking at how few producers there are in the industry, and how a majority of producers are small scale.



Assessing the work of input suppliers shows us how essential they are to the wine production process. Without the laborious farm work, which creates the basis of winemaking, wine cannot exist. This essential task creates the most number of employees, but adds the least amount of value to the finished wine bottles value.

5.2 Wine Cellars

Firms specializing in cellar services manage wine production between the stages of receiving grapes from the input suppliers all the way to producing the final wine before it is bottled. Wine cellars are responsible for one of the most important aspects of insuring quality: ageing. Corked wine is stored for varying lengths of time to improve its quality, taste, aroma, and general complexity. The quality of wine is impacted enormously by how well it is properly held in a wine cellar. Fine grapes alone do not guarantee a fine wine without proper ageing.

Cellars are either independently owned from family traditions or are commercial firms with strong market shares. Between 1996 and 2001, the number of wine cellars grew rapidly from 260 to 355 and there is reason to believe the number is increasing by the year (NAMC, 2002:17).

Cellars do not have strong *vertical power* on enforcing demands in the value chain. They mostly wait on input suppliers to prepare the wine for storing. Cellars however may have *horizontal power* by competing with other cellars in the Southern Cape region. *Development services* are available to some cellars by way of loans, which can also influence their horizontal power on the chain. When certain cellars meet the loan qualifications dictated by lending agencies, this can place the cellar in a position of economic power by either economies of scale or economies of scope.

In theory, cellars are in a position to age their wines for fine quality, which would then lead to creating higher added-value to the end-product. But in practice, this would create a very unequal relationship when comparing South African wine cellars to for instance, French fine wines of high quality. The South African wine industry as a whole is shared by common agreements regarding which wines are to be produced based on type and quality. Creating a South African brand fine wine can compete with the taste of other fine wines from abroad, but the South African value chain itself is not yet able to compete with similar wines from abroad. Thus South African cellars' power is dependent on the South African wine chain and the South African wine chain is still in some respects dependent on the wine chains from abroad.

The increased processing capacity and expansion in the sector also shows how important cellars are in the industry. Because of this, state regulations have imposed employment conditions, where more than 25 laws insure proper labor conditions on farms and the well treatment of people regarding pay and handling sickness. These policies all attempt to safeguard proper working conditions: they are the Labor Relations Act, the Employment Equity Act, the Skills Development Act, and the Basic Conditions of Employment Act.

Not least attempting to safeguard proper labor conditions, government policy has also attempted to implement *development services* to help ease the post-apartheid deregulation process of the wine industry. This has been on the basis of two measures: first, to promote development of land reform and secondly, to help non-white farmers gain entry to the market. The organizations helping to implement these policies are the South African Wine Industry Trust and two subsidiary bodies, the Business and the Development companies. But as discussed earlier (refer back to section 4.3), once non-white farmers acquire land, they face many challenges maximizing their outputs to increase value, let alone passing the challenges to acquire farmland in the first place.

5.3 Wine Production

Following the institutional changes South Africa has seen as a result of democracy, South African wine production has become one of the ‘emerging producers’ of global wines (Scatigna, 2009:213). Producing wine does not end at the bottling or storing stage: packaging, product development, and marketing are essential to the production and value-added process. Packaging is arguably the most important service in promoting a certain wine quality. Bottles, casks, or foil bags all attempt to influence the end market’s perception of the quality of a particular type of wine. Contrary to the heavy physical labor required by input suppliers, firm’s working with wine production work under much less physically extreme conditions.

Given the multitude of tasks during the production process, trusted cooperation is essential to perform the necessary duties. A strong *inter-firm*

relationship between wine producers and tourism and exporters promotes mutual power-neutral and equal relationships among wine producers and other firms. This is compared to the unequal inter-firm relations between input suppliers and firms higher up in the chain. While there is fragmentation between the owners and laborers on the fields, the owners and workers responsible for the production process are based on a mutual relationship for wanting to create a successful and quality-based finished wine. Information is shared strategically within each production firm to maximize gains and lower production costs.

From a *horizontal* power perspective, there is an equal power structure within the firm, but an unequal power structure among competing firms. This is generally due to differences in firm space, contracts with grape growers, and financial power over other production firms. *Vertically*, all production firms carry power over input suppliers by settings demands on quality, time, and quantity. Demands however are not always set up by the production firms themselves, but are based on agreements from international retailers who will only stock and sell certain wines based on the quality of wine.

Despite such demands, there is an enormous potential for wine producers to upgrade their position within the supply chain and create increased value for the final wine product. To do this, producers need to secure a credible and consistent track record for delivering quality products. Upgrading also occurs when production firms compete against each other. However when this occurs, the opposite becomes true for the firms who become downgraded on the basis of another firm adding increased value on the basis of market share or decreased manufacturing or input costs.

From the producer's perspective, an export-competitive product such as wine carries other benefits as well (Moodley & Velia, 2002:vii). Producing large volumes of wine for sale on the international market creates the possibility of economies of scale. The larger the production value, the cost of resources needed to produce becomes cheaper. This is also the case for actors further up the chain, including logistics. When shipping contracts are made, there is little price

variation between 10,000 and 20,000 bottles of wine, as long as they all fit within the purchased container that is shipped.

The international value of the South African Rand is also an important point in determining the value of wine, but is often also a contested issue. If the Rand is undervalued, most of the added-value is created past the point of processors and traders. Thus the added-value to the product is retained abroad to the international firms outside the country. If the Rand is overvalued, international buyers may be skeptical purchasing wine because the consumer cost of the product will be on par with more luxury based wines, but South African wine will still continue to be a mid grade wine, thus being too expensive in relation to the other higher priced, higher scale wines from other countries (*Ibid.*, p. vii).

5.4 Tourism

Soon after the start of post-apartheid South Africa, national and provincial policies were established to promote the tourism sector and attract both domestic and foreign visitors amid the country's negative images of apartheid (NAMC, 2002:20). Strong public relations campaigns were put in place to inform the public of the beauty and wonders of the country and its wine sector. Since the end of apartheid, wine-tourism has amounted to 17% of wine-industry's GDP to the country (refer back to figure 7)¹⁷ and the number of visitors to the industry is predicted to grow per year (Bruwer, 2003:424). Wine tourism provides visitors with the opportunity to visit vineyards, wineries, and wine-tasting events.

The impact of wine tourism on the country goes far beyond the wine value chain. The sector is very diversified in its *territoriality dimensions*. Some vineyards that can attract tourist are located hundreds of kilometers apart, while others are condensed regionally. It is one of the few services that can promote regional development and ultimately generate employment into non-wine related sectors (SAWIS, 2009:35). A well functioning transportation infrastructure is needed to allow tourists to visit farmlands found often only in rural areas. This helps create a market for lodging, trade (*Ibid.*, p. 35), and other regionally-based

¹⁷ Figure 7: Percentages of value chain GDP contributed by South African wine services; found in Section 4.2: *The Macro-Economic Landscape: Who is Getting How Much?*

sectors: wildlife, cultural and historical sites, natural attractions, and heavy consumerism by tourists (*Ibid.*, p. 8).

Tourism firms rely on the state for creating a *business environment* to help sustain growth of the tourism industry. The state must help with regional planning to create efficient transportation networks to help make vineyards accessible. Wine tourism firms are at a particular advantage for being able to receive attention when the country's tourism industry markets South African tourism.

Wine is also one of the few commodities that are strongly branded on its geographical origin (Bruwer, 2003:424, originally discussed by Merret & Whitwell, 1994). Wine tourism is a reflection of good wine. Tourists don't respect vineyards of poor quality and if the wine is as such, tourism will drop. Tourists are motivated to see South Africa's vineyards because of their appreciation for South African wine. Their respect for South African wine is what drives their tourism. Thus the *vertical power* of wine tourism is relative to the quality of wine production. If wine producers are not capable of branding and marketing South African wine for its quality, taste, texture, etc, to the *end-market* consumer, the tourism sector will be a reflection of the poor quality of wine production and as a result, tourism firms will suffer.

5.5 South Africa-Based Retailers

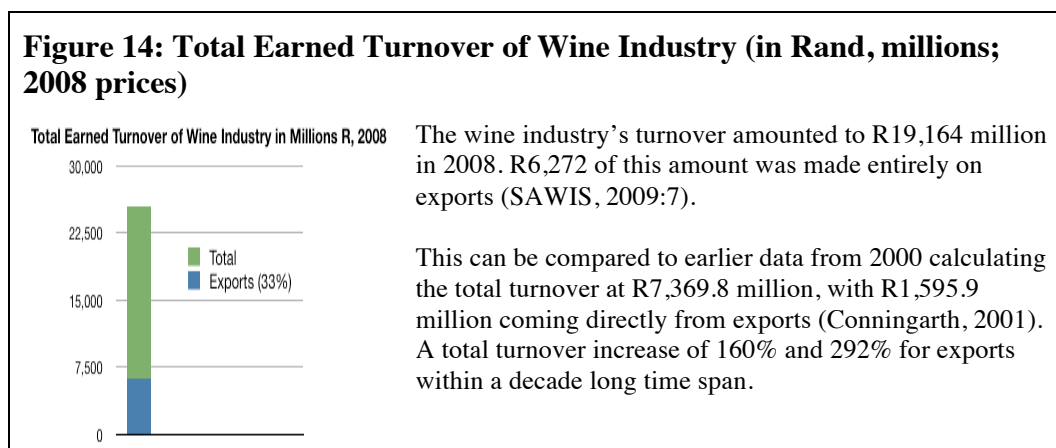
Hundreds of South African-based retailers exist for consumers to purchase wine. The contributions that retailers make to the chain also depend on how well they can deliver wine to consumers. Retailers have to consider certain aspects to best give them an advantage to reach the *end-market*, including how well they are located, how accessible they are, and what consumers they attract. Historically however, during apartheid, whites were targeted by the wine industry as principal consumers of wine, while beer was an alternative for the non-white populations. Further assessments that can be made regarding national retailers are similar to those of international-based retailers, later discussed.

5.6 Processors & Export Traders

When the international community lifted sanctions on South Africa at the end of apartheid, the country’s agricultural and wine-based exports have raised the country to becoming the 8th largest wine-producing country.

Export traders and processors are next in line on the value chain after the product being handled by wine producers. There are 71 firms that buy wine for export purposed only (SAWIS, 2009:20). Wine traders act as middlemen principally engaged in moving wine from the hands of the producer to the exporter. Their knowledge of the value chain as a whole is limited and can generally only answer questions regarding how to navigate away from trade barriers and other government and policy-based laws that can hinder the wine's export.

Traders take responsibility for collecting wine from multiple firms or traders can also act as an organizer for cooperating firms for the mass distribution of wine for international trade. Wineries, producers, and wine associations can sell directly to traders who then resell wine to medium and large-scale processors and exporters. Trader’s work with exporter’s to set and consolidate production, standards, and improve wine quality. The essential nature of traders have helped make exports create one third of the industry’s value (see figure below).



Traders also attempt to form close business relationships with producers and input suppliers. Traders know that the actors lowest on the value chain are also the actors with minimal liquidity and thus input suppliers are in need of credit

to counteract the risk of unstable grape outputs. Traders can work financially and provide credit to debt-burdened, poor farmers; they can also positively influence the stability of the trader-producer relationship. But traders are not lending institutions are also limited to the quantity and extent of how much they want to lend. Traders lending credit lack the potential for economies of scale compared to the larger institutions that are more specialized in lending. Thus this lending trader-producer relationship can also be seen in relation to external development services that create and maintain a wine market based on the continuous production by way of microloans to input suppliers to help deal with unforeseen or unmanageable issues that prohibit optimal wine production.

To help against problems amongst producers and input suppliers, and because traders act as middlemen and thus ensure the communication process between the domestic side responsible for production and the international side responsible for supplying international consumers of South African wine, traders carry a powerful weight in being able to dictate and enforce the demands represented beyond the borders of South Africa and into the international realm of the wine industry.

Traders are the last domestic actor to handle wine before it is ultimately exported abroad. Thus they have particular *vertical power* revolving demands and negotiations, both to domestic and international actors. Traders act as representatives on the behalf of the international market to dictate to South African domestic producers and input suppliers what requirements are needed for their wine production to be sold internationally. This can include packaging, quality control, size, grape variations, and ultimately being part of a certification process validating the type and kind of wine that international retailers would carry and sell.

Traders also have negotiating power when working internationally with exporters, wholesalers and global retailers. While these international actors dictate the market requirements to sell produced wine, traders have the power to act as representatives of South Africa's wine when the country's wine market is facing market challenges such as weather and agricultural dilemmas and product

shortages. International buyers must face these circumstances, and with the help of traders, South Africa's input suppliers and producers will have a common voice in reasoning with international buyers regarding external factors that prohibit South Africa's wine industry from producing optimally.

Traders need strong *inter-firm* relationships to accurately forecast the demand of South African wine from international-based retailers. Because traders act as the middle-man between South African producers and the international market, no other firms are communicating to each other regarding how many bottles of wine are being sold and how many more are needed to replenish and stock shelves accordingly for customers to purchase. Not foreseeing the market and consumers demands of wine, the entire chain is at risk for either over-producing, under-producing, or worse: temporarily stopping the chain and production of wine.

Traders are placed at a great advantage by being the last operating firm to handle wine before export and the first firm that international handlers must face when importing. They are not at risk of being threatened by domestic firms upgrading over them and they are not at risk of being downgraded, unless international buyers handled directly with producers and input suppliers. If this would occur, producers and suppliers would lose their cooperative negotiating power that was shared by being represented by traders.

5.7 Logistics & Supply Chains

Logistics and supply chain management are two particular processes that work together to ensure that the finished product can reach its way to the final *end-market*. The process works by taking South African wine and ships it to its national and international consumers. The value of this process is invaluable. If consumers cannot physically access and purchase the final end product, the act of producing a bottle of wine is minimized to where only the producer can achieve satisfaction by consuming the product themselves.

The final cost of what the end market pays for a bottle of wine is not equal to the total cost of how much it cost to produce that bottle of wine. Logisticians

who manage the chain of wine supplies organize the interactions between all levels of the commodity chain, from producer to consumer and in between. Supply chain managers are responsible for buying products and services through a range of third parties that when put together, streamline the wine delivery process.

When input suppliers are finished with the first stages of wine production and general viticulture practices, wine producers need to physically access what the input suppliers were last working on. Supply chain managers consult with both input suppliers and producers to then negotiate a detailed process for how the exchange of materials will be made. This is a very detailed process that requires good *inter-firm relations* and meticulous consideration of many aspects: time and product delays, damaged goods, and external weather factors.

Unfortunately, logisticians and supply chain managers do not have a clear operational strategy for guiding and moving wine production to the end market. In a study by Meissenheimer (2001:26), he draws attention to a “low level of strategic and market co-ordination between producers and exporters.” Considering that the end market can be up to 10,000 kilometers away from South Africa, some international wine markets such as Japan, the US, and Europe can be removed if the logistics are not properly in place to deliver South African wine. If supplies are not constant, retailers can easily replace wine selections with other wines that are cheaper, consistent, and locally produced (*Ibid.*, p. 26). If this occurs, wine producers also ultimately lose in-store retail advertising, which can hinder consumer interest.

Considering these factors, it is clear that logisticians and supply chain managers have enormous *vertical power* over the national and international supply chain of wine. However, if they cannot or do not properly adapt to the needs of the supply chain, all actors within the chain suffer greatly. If however the delivery of materials and wine is consistent, this can create and increase the value of the finished bottle.

The value chain can also be affected by a *horizontal analysis*; if logisticians do not properly manage their deliveries from input suppliers to producers, small businesses such as input suppliers can be at risk of ultimately

being excluded from the chain and from delivering important value that can be added to the finished product by delivering quality harvesting and destemming. However, advancements in telecom communication systems have also streamlined logistic services worldwide. Containers and shipping have led to valuable savings not only for logisticians, but the entire supply chain itself.

5.8 Wholesalers

Wholesalers are used to receive bulk orders of wine that was received for delivery from the last South African-based firms service firms that handled the product: wine producers and export traders. Wholesalers receive the product for further distribution to retailers. This simplifies the process of instead making wine producers responsible for delivering wine directly to retail outlets. This approach generally leads to a more efficient distribution process, where producers are able to work with fewer entities and wholesalers are able to carry out the distribution for the producer.

Wholesalers however do not always focus themselves as ‘wine-only’ distributors. They carry other commodities for resale and the more commodities, the higher their economies of scale and cheaper their operations. Thus even though they are important part of the input-output structure for linking the wine-chain to the next actor, wholesalers do not add value to the wine; they instead add product cost. They act as a receiver of wines that were exported from South Africa, which have at this stage been imported and the wholesalers are first firm to receive them internationally. *Vertically*, wholesalers work closely with supply chains to efficiently receive commodities in a sustainable and quick manor. The longer it takes for wholesalers to receive South African wine, the longer it takes for retailers to stock the product. If this occurs, this seemingly small incident in time delay can hinder the entire wine chain by creating an oversupply due to wines that are still being shipped, creating an overstock of wine, if warehouses receive them all at once. Alternatively, there could be an undersupply from the retailer’s side if they are unable to stock their shelves of wine due to the lag stemming from the logistics and shipments to the warehouses.

Wholesalers do not need to directly reflect on the *end-market* and how to improve the sale of wine to them. As said, wholesalers can simultaneously stock hundreds of other commodities and if they specialize only in the resale of alcohol, the varieties of wine and beer can total up towards the thousands. Thus if bottles of South African wine do not continue their way up the chain to the retailers, wholesalers can simply discontinue receiving the product entirely.

5.9 International-Based Retailers

Retailers are among the last set of actors in the chain to handle bottled wine before it reaches the end market (consumers). The largest markets for retailers are found in the Western Europe, which has historically been the case for many centuries (Anderson, 2001:4) and make up approximately half the global wine market (Wittwer, G. et al. 2003:11). The process of retailers selling wine can be characterized by one of two ways. Retailers will either offer a selection of wine for sale directly to individuals or in some cases retailers will sell to smaller businesses who generally specialize in specialty wines (also known as wine boutiques). When retailers resale and extend the wine-chain to boutiques, they are able to add a percentage-based markup, which then increases the retailers revenue. No added value is actually created for the wine. It becomes a service-fee at the expensive of the boutiques.

The more common approach though, is the former of the two, where retailers sell directly to the consumer. This gives retailers enormous *vertical power* within the value chain structure. If retailers do not stock and sell South African wine, they potentially have the power to fundamentally change the macro-economic structures of the industry and have enormous leverage in destructing South Africa's wine industry as an export commodity.

Wine is a commodity that faces competition from other wine-producing countries as well. When consumers look to purchase a bottle from retailers, their perception of South African wine can vary based on how well the wine is stocked, where it is located in the store, and if it's easy to access. Retailers also have a role in how they influence consumer's perceptions of South African wine. Consumers

could perceive it as a low-scale wine if the retailer places South African bottles side-by-side to other imported wines from more respected wine-producing countries.

Retailers are also aware of the *vertical* influence they have on the industry. They can pinpoint the wines strengths and weaknesses. Retailers are in the market to sale various wines and if one wine does not consistently sell, retailers make up for it by either removing the wine or by changing their sales strategy to push other wines to the consumer. Either one of these approaches will create a loss of sales and revenue for South African wine production.

5.10 End-Market

The industry's ultimate goal is for the end-market (consumer) to fill a glass of South African made wine. The end-market is a term that categorizes the last set of actors that handle the final transaction of the value chain: the consumers. These are typically private individuals who purchase wine for private consumption. The parts of the South African industry dealing with the production level must understand what consumers expect of South African wine. In the case of South African wine, because the *end-market's* great influence on the chain, they can be described as a *lead-firm* due the influence they have on the procurement operations among actors in the chain (Ponte, 2007:1). Producers must meet the end-market's demands or risk losing a strong customer base from frequent buyers. It is much more difficult to convince consumers to buy South African wine who are purchasing a bottle for the first time than it is to retain buyers who generally prefer South African wine.

Generally, marketing strategies tend to look at the end-market as the main base to research; if the wine industry does not tend to the needs of the end-market, the value chain of wine can see an enormous drop of value in all firms and sectors. This is due to the nature of the *buyer-driven* supply chain. Because retailers and end-markets drive the production of wine in South Africa, local producers must know who their customer base is. If the industry does not understand who is drinking South African wine, little can be done to help

motivate the decision for consumers to choose South African wine out of a selection of other international-based wines.

Governing actors within the chain however also influence the final cost the end-market pays for wine. High tariffs, abnormal taxes, price supports, direct and indirect subsidies have all been found to inhibit the total price of wine (Labys, 2002:13). The reality that such factors can increase the price of wine to consumers however shows that the price of wine is not entirely based on how much value firms add to the wine, but also how much cost is added by external governing institutions, such as the state, that influence the cost of wine.

5.11 Looking at the map: summing up the inter-firm linkages in the value chain

What does studying the inter-firm linkages in the value chain tell us? To begin with, let's answer this question starting at the end of the value chain. Understanding the end-markets are essential to the value chain, not least because it is the goal of any industry to convince buyers to purchase commodities, but studying the end-market is an important source for understanding the industry and its limitations, what firms trade among what services, and how the end-market can drive the chain. This helps us understand the industry as a whole, instead of a single link of individual firms and actors. In reality, these individual firms help complete the chain and without the chain itself, individual firms cannot exist. Putting the chain of actors together helps provide us with a macro-picture of the chain itself. But in order to do this, we must first assess actors within each service individually. Understanding the micro-picture of each firm helps us then to see the chain's limitations and the disadvantages that firms face as a result of the governance of the buyer-driven commodity chain.

The value-chain of South Africa's wine industry can be characterized by the following services and linkages: first, input suppliers handle the manual labor aspects of all general grape and viticulture aspects. Collected grape materials are prepared for making wine and are then taken to wine cellars, where wine materials are then aged for quality. When wine is finally prepared, it follows on to the next

service stage, wine production. Here, wine is prepared for the bottling and packaging stages.

At this point, the influence that wine has on the industry can take three different routes. Wine continues on and is either exported internationally, or it is sold through South African-based retailers, or the wine bottling and production process creates a niche market in the industry as part of South African wine tourism.

The tourism branch is very influential in promoting non-wine related industries and services. For instance, services required for urban and rural development to create pathways for tourists to visit potential tourist-based vineyards. The wine tourism sector heavily promotes South African wine by becoming reflected on the tourists themselves when they return to their homelands.

If wine is sold domestically, the industry faces the limitations of a very limited consumer target; they have historically targeted the white populations as wine drinkers. Exporting wine on the other hand has led the industry to unprecedented growth. This is partly due to the firms and actors involved in post-export operations. Processors and export traders are the last set of actors who handle wine in South Africa. They are responsible for helping the domestic side of the chain communicate with the international side to shift away from the barriers that would otherwise make it very difficult, if not impossible for international-based actors to receive the product. After this stage, logistics and supply chains follow. They are principally concerned with transporting wine from one actor to the next in succession. When wine is finally shipped internationally, wholesalers are the first actors in line to receive the product. Wholesalers do not sale directly to the public, instead they host wine and a wide range of commodities for further distribution. This helps simplify the process of retailers purchasing wine from wholesalers, instead of retailers needing to purchase directly from wine-producers in South Africa. This helps the chain become more streamlined, with each set of firms contributing services to help the flow of wine from one actor to the next. The industry's ultimate goal is to motivate the end-market to consume wine.

6. Assessing the Inter-Firm Linkages: What Can We Learn?

After constructing the value chain of wine, looking at the macro-economic makeup and distribution, discussing the difficulties of post-apartheid land reform as an approach for reconciliation of past wrongs, and pro-poor growth as a policy-driven strategy, what can we learn by assessing the earlier discussions in relation to each other? The following are four outcomes that we can gather by assessing the inter-firm linkages that the value-chains of wine have had on the poor households of South Africa.

6.1 The poor are included in the value chain, but current chain structures prevent them from chain-upgrading

Exclusion is not the reason why economic growth among poor populations has stagnated, because rather, the poor are included. The current structures however are at fault for perpetuating the poor's inclusion with low-wages and low-skilled employment in the chain. Actors who were previously economically excluded during apartheid have now been included in contributing to the value chain of wine. This we can see by looking at the macro-economic growth the industry has provided (refer back to figure 8). But wage earners in these newly included firms have not been impacted beneficially in reducing their household poverty levels.

Why is this the case and why are small value firms not upgrading to more value-added positions? Can low-value-adding firms add more value in the chain in that service? Do they need to look instead at trying to enter other services that will add more value to the commodity and create higher economic returns?

To answer these questions, we have to look at it through the context of innovation. Firms at the top are the most innovative and it has led them to upgrade to the most added-value positions. Low added-value firms do not have the innovation needed to upgrade; not because they lack the intellectual process to do so, but because they lack the resources needed to carry it out.

Firms most likely to upgrade the value they add to the chain do so by minimizing their operation costs and increasing their economic returns. With the

help of globalization, international businesses are constantly improving their operations for maximum efficiency. Firms are learning that an approach to lowering operating costs can be done through improving the firms operating efficiency.

Learning how to improve efficiency isn't done through trial-and-error, it's done by learning from other companies and comparing how operations are done abroad. South African firms need to learn from this as well and they are lagging behind. To prevent South African firms from trailing, they need to constantly move at the same fast pace as done by other international firms.

Because of the advantage that international firms have on holding a tighter grip on innovation, they are more likely to upgrade their value on the chain and become chain drivers. They are doing this by acquiring new methods to make their services more efficient by designing new marketing strategies or abandoning current low-value-adding services and focusing entirely on high-value-added services (Oliveira, 2008:9).

Another approach South African firms can use to help strengthen their prospects for chain-upgrading could potentially be to attempt to exploit economies of scale and specialize and exploit their comparative advantage within the industry. Increasing economies of scale however could potentially have the negative result of fewer workers are doing more tasks of what the normal amount of workers would do. Positively however, it could result in the same number of workers increasing their task output and the firm would see a revenue increase leading and workers would see an income increase. If the outcome is positive or negative would depend on the service firm; the wages of farm laborers are at the bottom of the scale compared to the international-based firms who have less workers, but receive higher incomes.

6.2 The higher their international position, the higher the added-value

The higher up the service or firm is to the international market, away from the primary production level, the higher the value they create to the end-product. This outcome is apparent when looking at the input-output structures within the

chain. When we look at the links and sequences of the chain, more value is added by the firms who are furthest away from the South African market. This we can see by looking at the economic distribution of the wine industry (refer back to figure 7). The closest they are to the domestic market and to the lowest point of processing, the least amount of value is added to the sold bottle of wine. Why might this be? This question can be answered with the help of understanding buyer-driven supply chains. Because South African wine is not in a position to set the demands on the sale cost of wine, they are not in the position to create a buyer market on the product.

The market is made by those furthest away from the input suppliers. Only with exception can wine be marketed by the producers with a supply-side, producer-driven approach. This is observed when looking at the finest of French wines. Certain wine producers already have the market share to demand a sale price that will be accepted by consumers. South African wine unfortunately is not one of these wines. The restricted nature of South African wine also stems from their inability to upgrade its wine quality. This is due to the decisions made by partnering wine organizations on the behalf of the South African wine industry that suggest the wine grade and quality that will be offered and sold abroad.

The shareholder value doctrine shows us that international interest in any industry is to exploit all available resources to make the most revenue possible; which is also their main motive for being in business in the first place. International firms and investors already have the rents needed for investment and are not in business to escape from poverty; rather they are already far from poverty and wealthy enough to make the investments needed from in an international business perspective without needing the development services that are needed by South African firms to help acquire loans to start their businesses.

The South African wine industry has not managed to take a hold of its own bulk of domestic consumers to purchase wine on a frequent basis. This is partly due to the old marketing of the past, which targeted the white populations during apartheid as the wine drinker based on class. This old basis of marketing is perhaps still ingrained in South African society. However of course, consumers

need to be in an economic position to first allow them the opportunity to consider purchasing wine in the first place. This is often an overlooked aspect. Poor households often are less able and willing to collect their household incomes to purchase wines, when cheaper alternatives of alcohol exist.

6.3 Post-apartheid land distribution has had minimal effect on poverty alleviation

The effects that land reform has had on pro-poor growth to firms in the wine industry have been negligible. The earlier discussions on if post-apartheid land reform has capped economic marginalization has shown us that reform has merely attempted to offer land distribution to the marginalized black populations during apartheid, but further steps to helping new land owners with maximum and optimal land use and production have seen fruitless results. This is particularly apparent when considering the previously discussed consequences of land reform to new small-scale land owners: when the previously marginalized receive state-provided grants to purchase land, they still lack the equity to purchase essential materials for more than the basics of land production. Grant recipients also have limited disposable incomes to upgrade to more efficient approaches to harvesting. As a consequence to this, new landowners instead tend to take a cooperative approach and attempt to collaborate with current white landowners who have had years of experience in agricultural production.

If grant recipients instead choose to purchase their own land, studies have shown how land has been used far below its potential for agricultural output (Lahiff, 2008:61). Besides lack of experience, new landowners cannot afford the input costs required to expand their production as needed by input supplying firms. Grant recipients also have limited disposable incomes to upgrade to more efficient approaches to harvesting. The alternative to not having the necessary irrigation tools is dryland cropping (or dryland farming). This method makes land completely dependent on rainfall and completely risks putting an end to the constant flow of outputs, because rainfall cannot be guaranteed.

When new landowners however do begin to agriculturally exploit their lands, questions arise as to whether their land outputs are productive. New

landowners tend to have narrow goal oriented approaches to their land use, which further restricts optimal land use (Lahiff, 2008:62). When land is farmed on, new farmers tend to limit their efforts to commodities outside the wine sector, which also restricts their revenue and profitability. Herbs, fruits, plant materials for traditional medicine, wood, and wild animals are bread on farm lands which provides virtually little to no commercial gain (Lahiff, 2008:63).

Newly purchased land farms also tend to lack the infrastructure needed for harvesting; this includes lacking water resources, electricity, and clean sanitation (Lahiff, 2008:63). Land may also be located in underdeveloped areas that lack food markets, health clinics, and schools needed for families to maintain their livelihoods above the poverty level (Lahiff, 2008:63).

Methods for assessing if land distribution has helped lead to economic growth of poor households can also have differing criteria: e.g. it could be measured by asking if the general welfare of society has improved or by measuring the economic impact of households. This study assesses how well the effects of land reform have had on pro-poor growth is based on calculating economic returns that households receive from the value chains of wine.

6.4 Stronger businesses environments and development services are needed to support new firms to chain-upgrading

Unequal power relations within the value chain are preventing South African-based firms from upgrading their value on the chain. In essence, this situation creates competition of all actors in the chain, dominated by the current chain-drivers. Chain-drivers are in a position defend their lead-chain position if low value firms would somehow try to impose a threat and compete with the high-value firms. High-value firms have the resources needed to stabilize their chain-driving position in the chain and counter-act potential threats imposed by low-value firms. The wine industry has had mixed results in helping with pro-poor economic growth. People have seen an increase in household income to purchase basic services to sustain their livelihoods: food, water, shelter. But there is little possibility to upgrade up the value chain. In order to do so, South Africa needs more supportive business environments that can help provide a boost for low-

income farmers to make the initial investments required for a successful wine-agro-business startup.

7. Conclusion

South Africa's wine industry is a complex network filled with interrelated businesses and actors that cooperate for the common goal of producing wine and getting into the glasses of consumers. In its basic form, the wine industry is represented firstly by all of the domestic actors responsible for the production and trade of wine and secondly, all the international actors responsible for handling and exporting wine from South Africa to reach international markets and help promote the consumption of South African wine abroad. By way of concluding this thesis, the following will recapitulate the major points and discussions gathered during the course of this study.

Wine is an agricultural commodity in nature and as such the industry can be broken down similarly to other commodities such as coffee. However studying wine carries a notable difference: there is a very complex web of actors that handle the production process from fresh grapes, to harvesting and fermentation to the ladder processes of trading, distributing, marketing and selling. Domestic producers along with input suppliers are responsible for growing grapes and the end process of what ultimately leads to a corked and full bottle of wine. Before the bottle of wine can be consumed, traders help negotiate the price to the international market and the quality which is demanded.

The effect that the South African value chains of wine have had on pro-poor economic growth has been varied, all depending on who has received the economic returns. Despite the business and development services provided to national based firms, these firms have not been able to upgrade to higher value-adding links of the chain and have yet to see an increase in pro-poor growth. Actors working at or having contacts with the international level have however seen an increase in economic returns, but they were never the actors that the poverty reduction strategies intended on helping to see a boost in their household earnings.

The research of this thesis has also highlighted the following points regarding the inter-firm relationships within the chain in consideration of who receives what economic returns.

The excluded of the past are now included in the present

By analyzing the data and linking ten firms together working in South Africa's wine industry, we can see that the formerly excluded populations during apartheid have now been economically included in the value chain and some pro-poor growth has been achieved. But now, they are being excluded from making advancements and creating more added-value to the chain; this is observed by looking at the chain as a whole and seeing who is working in what service.

Low added value firms want to add more value to receive more payments in return, but in order to do this they need to upgrade their position in the chain. Looking at this scenario in relation to value chain governance shows the structural problems of the chain: if all actors want to add value to the chain, then no firm will ultimately exist and remain as an input supplier, thus there is a need for greater equality within the chain to shift economic returns from a sold bottle of wine back to input suppliers, which will then increase their returns.

Obstacles are prohibiting firms from chain upgrading

Low value-adding South African-based firms face numerous obstacles in creating more added-value to the chain. They face difficulties in actualizing innovative practices, particularly because they lack the resources to pursue them. Firms most prone to chain upgrading are able to minimize their operations costs, while also increasing their efficiency. Such firms that are capable in cost-reduction practices are also firms that learn from other sectors and implement company wide changes to initiate best practices. The firms most capable of applying the best business practices and as a result upgrade their value are the firms which this thesis has found to work internationally; these are firms that either trade wine abroad or the suppliers that stock and resale South African wine for consumer consumption. Firms unable to do this, as we have seen in the

analysis and previous sections, are firms working and specializing mostly in the primary agricultural and production stages of the wine development.

These obstacles are also particularly faced by first-time landowners who have purchased land with the help of the state's land distribution programs. Due to their lack of experience, new landowners don't have the skills to optimally exploit their lands to gain from agricultural production. They also don't have the capital required to afford the basic input costs needed to start, sustain, and expand their production. This is due to the limited disposable incomes that new landowners have to invest in their farms, which also creates the situation for them that they are then unable to upgrade to more optimal methods of harvesting.

Firms with international operations are more likely to be chain-drivers

Branching from the last point, firms orienting their businesses internationally serve as an indicator as to where the chain-drivers are located within South African's value chain of wine. This observation can be made from looking at the data, discussed in section 4.2, *The Macro-Economic Landscape*, where we can see that exports turned over double the revenue compared to input suppliers.

International-based firms are only willing to enter the market if significant returns of revenue are nearly guaranteed. If a scenario took place where the investments of international investors were at risk, investors would instead place their investments elsewhere, in a more secure setting, away from risk. If this scenario would take place, this would push more value onto the chain from South African actors, but there would then be a significant risk that South African wine wouldn't be able to be exported sustainably and consistently sold abroad.

The research has also shown that the higher the service or firm is to the international market, the higher the added-value to the chain. This is particularly clear when looking at the value chain as a completed web of actors and drawing attention that firms working in primary production-based services add less value than firms working closer to the end-market.

Unfortunately for these low-value primary-based firms, the South African wine industry, with its roots as a buyer-driven supply chain, is not in a position to set the demands on how much wine will cost to the end-market. The wine industry is not in a position to create a buyer-market for South African wine. Instead, they can merely tap into the international wine industry and strategize how to compete against the French, Argentinean and other internationally-based wines.

Land distribution policies have had varied success in increasing chain inclusion

Post-apartheid governments have attempted to increase economic activity of the formerly economically excluded populations of the past by way of land distribution to the country's non-white populations. The historical advantage that the country's white populations have had is significant. Because land ownership was reduced to those of white color, the non-white populations became inherently excluded from entering any business within the primary sector-based, agricultural industry.

Land distribution policies were enacted to help counteract against such inherent disadvantages. The state enacted policies to grant the formerly excluded populations with vouchers which could then be cashed in towards of the purchase of land deemed for sale by existing white land owners.

New landowners however have found that the farms they can afford with state grants, lack general infrastructure on and around their farms. Water resources, electricity and sanitation equipment that are needed for general farming and harvesting are not accessible to farmers; either because they cannot afford to make these investments upon taking control of their land or because of general lack of state support to promote infrastructural investments to help create an assessable transportation network for shipping between rural farms and urban areas.

There is a need for stronger businesses environments and development services to support new firms to chain-upgrading

Full cooperation from all actors helps maintain the chain's sustainability and minimizes income inequalities. The chain needs its actors to cooperate and maintain strong inter-firm relationships among each other to minimize income inequalities among the different firms. In order for this to happen, power relations among all actors need to be equal. The creative process costs more money than manual labor. The problem is where that actual work is being based. The problem isn't that intellectual workers get paid more; the problem is that intellectual workers are based internationally. South African workers have the intellectual capacity to fulfill the work, but the structure of the chain makes it difficult for South African firms to upgrade in the value chain.

The state is a particularly relevant actor in this discussion. The state may be criticized for 'not creating jobs', but in emerging economies that revolve around the free-market, questioning the role of the state is better centered around discussing how the state can best recruit and market South Africa to businesses who are willing to open operations and invest in the country. This is also particularly true when considering that South African entrepreneurs already have ideas that can be turned into marketable commodities, but they need a 'lift' through development services to help get their businesses get started.

Concluding remarks and recommendations

By way of studying and assessing the interconnected chain of actors in South Africa's wine industry and abroad, we can gather that even though a wide range of actors exist and participate in the chain, capital and value based jobs are limited to the actors characterized by dominating power relations. Those who are upgraded in the value chain drive the production process based on governing the guidelines and regulations, and those who are most orientated to the international market, are those who control the majority of value during the process of production to consumption.

This also entails a very unequal relationship. By dividing South Africa's GDP related to the wine sector, we can see that capital value of wine is added on by trade (54%), but primary agriculture only has an added value of 18% on the finished total value of wine. But when looking at where employment within the wine sector lays, 58% of unskilled laborers are working on farm fields in primary agriculture, while 13% are skilled workers working in more value added tasks including trade.

By considering the notion that it is advantageous for more actors and people to be included in the wine supply chain also means that more people are earning steady incomes. This creates a new discussion for policy makers regarding what to do with the disproportion of more people working in lower paid jobs but also seeing an increase in employment.

South Africa's present development as a country with a divided history among its citizens has come a long way in relation to their African neighbors. The impact the value chain of wine has had on increasing the economic growth of the country's poor however is a mere fraction among the other issues that are hindering further development in South Africa. Lack of public service deliveries, corruption, opportunity inequalities, unofficial racism, and political skepticism are among the many issues that the state must strategize in parallel to promoting economic growth. In areas where the state fails to implement strategies against such equally paralyzing issues, aid programs and development projects should target fixing inequalities within the value chain itself.

8. Appendix

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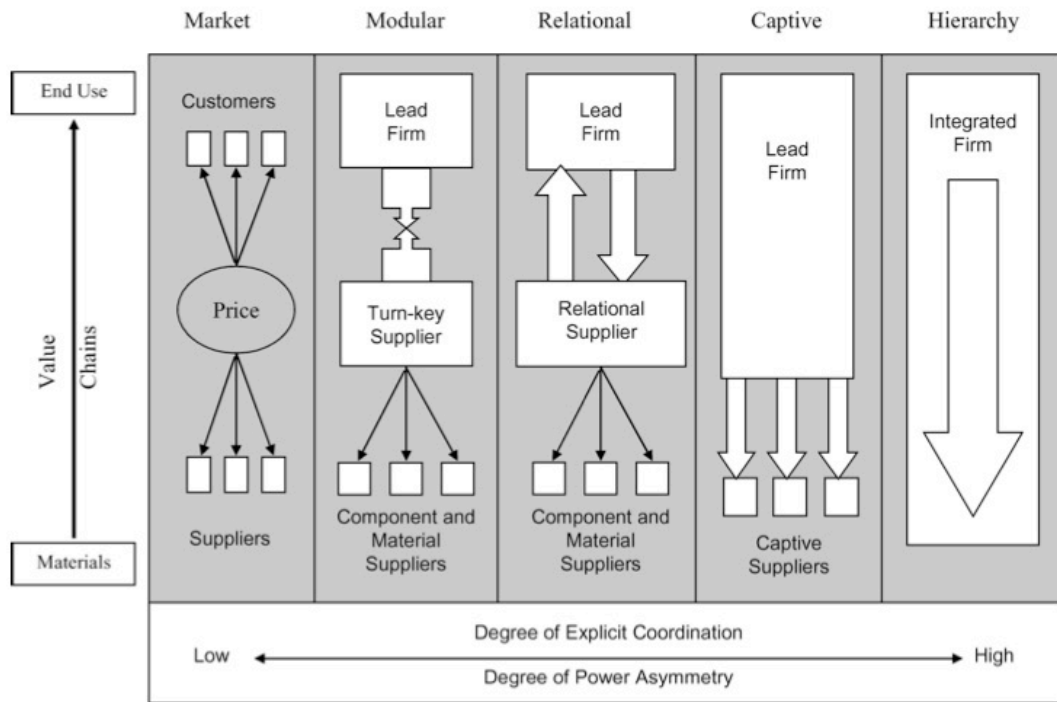
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II. Conceptual Diagrams

Figure 15: Five Types of Global Value Chain Governance



The figure depicts five types of how the governance of global value chains can be characterized (Gereffi, G. et al., 2005:89). Although not particularly applicable to South Africa's value chains of wine, the depicted forms of governance show how value chain analysis can be assessed, but are generally applied for other global industries e.g., technology sectors, automotive.