

Wine MBA Wine Economics Essay

Trophy hunters vs. wine lovers: Given the inflated prices for top quality wines, who's actually buying the wines?

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Trophy hunter vs. wine lovers: Given the inflated prices for top quality wines, who's actually buying the wines? While this may initially seem like a trivial question because it pertains to a certain strata of wine buyer/consumer, the implications for the entire industry are immense. The answer may provide clues to where the industry is headed, where the margin is in the industry, where companies should be focusing their efforts, and whether the increase in prices will continue over the long term or stabilize based on outside conditions.

The value of top quality wines has appreciated dramatically over the past several years. If you use Wine Spectator's Auction Index as an example, it has gone from a base of 100 in 1995 to a high of 299 at the end of first half of 2007. (Wine Spectator 2007) An even more dramatic example is the Liv-Ex 100 it has gone from a weighted base of 100 in January 2004 to a high of 247.80 in July of 2007, it has come down since then to 239.27 in October of 2007. (Liv-Ex 2007) Is there something underlying this increase or is it simply a matter of supply and demand?

In order to fully understand the question and its implications we need to define the terms 'trophy hunter' and 'wine lover'. Based on the phrasing of the question trophy hunter is in opposition to wine lover, so we will define the trophy hunter as a wine buyer who is always in pursuit of the prestige wines solely for the purpose of display, status, or investment not necessarily consumption and the wine lover is a wine buyer buying wine for the hedonistic pleasure of the wine.

The question then becomes, are the inflated prices of top quality wines due to increased consumption through hedonistic pleasure or are they due to purchasers looking for status and/or investment potential? The answer for me is that the price increases are due to both factors.

There are numerous reasons for this.

1. Top quality wines are now considered luxury goods.

There is status to be gained by owning and consuming high-end expensive alcoholic beverages. This can be seen in rap videos and wine merchant ads to wall street during bonus season. Stocked wine cellars have become an accessory to new luxury homes. (Lewis 2007) The price you pay has become a status symbol even if you may not appreciate the wine you are drinking, as in China were it is reasonable and normal to pay \$5,000 a bottle and still put juice, ice, or sprite in your wine. (Miller 2007; Seno 2007)

2. The increased ease of reselling a wine collection.

While there have been wine auctions in London since the late 1700s the true advent of the modern wine auction did not come about until 1966, again in London with Michael Broadbent at the helm of the new Christies wine department. (Hermacinski 2007) By 1977 wine auctions had also become a fixture of the American wine scene, but the true effect of the global consumer nature of the wine auctions was not felt until New York

legalized auctions in 1994. (Meltzer 2006) With wine auctions now established as a fixture on the global wine scene there were new avenues for the passionate collector, a new source of vintage wine and a new way to dispose of unused wine. Without this credible and transparent secondary market I do not believe that wine prices would be at their current levels.

3. Global consumer base, limited supply.

As the global economy continues to spread its wealth beyond the G7, China and India of particular growing importance, and number of millionaires and billionaires continues to rise, the prices of top quality wine will continue to rise. (Kakaviatos 2007) Even though it may seem that there is a lot of top quality wine in the world, those wines that have solid established records of quality are truly limited in how much they can produce in any given year. As the number of buyers that can afford these wines increases the demand for them will go up and therefore the prices will continue to rise. (Drinks Business 2007; Wiggins 2007)

4. Investment funds and the spike from English retirement investment scheme.

Over the course of the past couple of years there have been numerous companies that have established wine investment funds to help diversify investment portfolios. There was even a short period of time during which in the United Kingdom it was believed that a wine cellar could be part of your retirement investment account. Both of these added additional players to the mix. (Wiggins 2007)

5. Increased quality, increased consumption.

Since the late 1960s the worldwide quality of wine, overall and level of consistency, and fine wine in particular has increased dramatically. At the same time the amount of media coverage that these quality wines are receiving has increased as well. While this has helped the consumer find good quality everyday wines to drink it has also increased the exposure the public has to the consistency and quality of the top quality wines out there in the market today. So in the markets that are buying the top quality wines at record levels, there is a comfort in quality.

Do these points lead us to believe that these price increases are due to trophy hunters, wine lovers or both?

1. Top quality wines are now considered luxury goods.

The fact that the top quality wines are now luxury goods would lead us to believe that this would be a phenomenon instigated by trophy hunters, but it may also be due to the fact that these wines are of limited supply, the market is growing, and the historical longevity of quality of these wines is such that wine lovers are willing to pay for this implicit guarantee.

2. The increased ease of reselling a wine collection.

Again, the increased ease of reselling a wine collection would seem to be a point for the case of the trophy hunter, but perhaps there is more to the story. Some of the most prominent auctions of the past couple of years have been from passionate wine collectors that perhaps become overly consumed by the passion for wine, the Park B. Smith collection and the Golden Cellar are two that stand out.

While another impressive cellar that went up in 2004 was the Doris Duke cellar, this cellar was untouched by human hands for over 60 years. The history of the collection was that these great wines were consumed on a scale that would be hard to imagine today, grand parties of 200-300 where every course had a new wine and everyone was served the same wine for the course and the wines were always top quality wines. This sale provided an unprecedented opportunity for exceptional provenance and the prices were reflective of that.

In late 2005, Domaine de la Romanee-Conti, did something quite unusual in the market and went direct to an auction house with a collection of older vintages direct from the winery. Thus was again unprecedented opportunity to buy wines with immaculate provenance and the prices again reflected the added credentials.

If you were to solely look at the California wines that have been sold at auction over the past eight years we might get a better picture of who is buying and selling. Taking data from wine auction data aggregators, Vinfolio.com and WineAuctionPrices.com my company has compiled a list of all California wines sold at auction from 1998 through March 2006. When you look at the top ten wines sold at auction by total number of lots you get an interesting picture, only three of the wines have an annual case production consistently below 3,000 cases and only one consistently below 1,000 cases. So when you look at annual case production ranges and the total number of lots, you get the idea that while there certainly are a lot of these wines being put up for auction for most of these wines trophy hunter is a small fraction of the game, however those three wines with case productions consistently under 3,000 cases, the number of lots in conjunction with overall production suggests that the trophy hunter is playing a larger part in the pricing of these wines. (Gallagher and Rubino 2006-2007)

3. Global consumer base, limited supply.

The increase of the global consumer base for fine wine would initially suggest that it is the wine lover that is effectuating the pricing on the top quality wines, but when you look deeper and the fact that in the newer markets juices and other flavorings are still being added to the wine, it suggests that perhaps the status conscious trophy hunter is behind the price increases.

4. Investment funds and the spike from English retirement investment scheme.

While there may be an element of a wine lover in those that choose to participate in the investment funds and the retirement schemes, it simply cannot be argued any other way that it is the trophy hunter that is the driver of this segment of the price increases.

5. Increased quality, increased consumption.

With the increased quality and consumption, this simply cannot be anything other than the wine lover playing a hand in this segment of the price increases. While the trophy hunter demands quality, the wine lover demands consistency and quality. With a significant amount of top quality wine being allocated to high-end restaurants these wine need to be something the wine lover will continue to praise over the long-term.

So what is the final score, who is that is effecting the market more?

1. Top quality wines are now considered luxury goods. - Tie
2. The increased ease of reselling a wine collection. - Tie
3. Global consumer base, limited supply. - Tie
4. Investment funds and the spike from English retirement investment scheme. – Trophy Hunter
5. Increased quality, increased consumption. – Wine Lover

Now that we know that it is both the wine lover and the trophy hunter that are pushing the price increases, what does this tie tell us? I believe that this tells us that while the wine market will be effected by the vagaries of the global economy, it will most likely be sheltered by some of the wildest negative gyrations because there is an underlying level of consumption that the wealthy wine lover will likely maintain to cushion the impact of these fluctuations.

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