



**A Market-Based Pricing Model for Wines:
Test over the Period 1988-2007**
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Many papers look at the determinants of prices, reporting estimation results of so-called hedonic price functions where wine prices are regressed on a set of characteristics in order to determine which characteristics have a significant effect. Contrary to this approach, this paper suggests a simple model to explain the price of a specific wine in relation to the market.

In this simplified relationship, all factors explaining the price of a wine are summarized by two components: the market and the price of a basic/standard wine. Market pricing is a result of rational, utility maximizing agents acting under information constraints. An efficient market is one in which prices fully reflect available information. An implication is that no excess prices can remain because new information is quickly incorporated into prices and those prices in turn reflect that information back to all other market participants.

Using the terminology of modern portfolio theory, if all agents have homogeneous beliefs, then they all have the same linear efficient set of decisions related to the market. The expected price of any wine is equal to the price of a basic/standard wine (called risk-free price) plus a risk premium to take into account the volatility of the price due to expected higher quality. In this terminology, the price of risk (the measure of volatility) is the slope of the line between the expected price on the market portfolio and the risk-free price. This measure of volatility can be calculated for each wine, it is the covariance between the expected price of a wine and the market.

If there is a price for a portfolio that replicates the market, then this price reflects on average the overall information on the market and the measure of volatility associated with a particular wine should allow a classification of wines. To test this model, the estimation is based on data collected in the review of the Savour Club for wines for sale over the period 1988-2007. It is found that the price of wine is significantly explained by its covariance with a market portfolio and that this relation can be used to classify wine appellations. Results also show a strong relation between the reputation of the AOC and this classification. We can also derive from the results that wines having the same measure of volatility in relation to the market portfolio probably belong to the same commercial market for marketing purpose.