

Globalization, Superstars, and the Importance of Reputation: Theory and Evidence from the Wine Industry

Michael Gibbs, University of Chicago, mike.gibbs@ChicagoGSB.edu

Frédéric Warzynski, Aarhus School of Business, FWA@asb.dk

In this paper, we try to link the economics of superstars (Rosen, 1981), the effect of globalization, in a simple model of reputation (e.g. Diamond, 1989) to explain the increased importance of Parker ratings on price. We develop a simple model of pricing behaviour in the wine industry, i.e. a differentiated product of unknown quality for consumers. In this industry, experts' opinions provide signals to consumers about the quality of the wine and globalization increases demand for high quality wines and increases competition for medium and low quality wine. Therefore, reputation, seen as the accumulation of previous signals regarding quality, plays a particularly important role.

The basic idea is the following: in a globalized world, more customers want the best wines, increasing prices, while it brings more competition for average wines, so lower prices and higher exit probability. Higher reputation to produce products of high quality is linked to higher prices, and increased demand for a limited supply of these high quality goods exacerbates the effect on price, hence the superstar effect.

Using data from all wines tasted by Parker in California, the Bordeaux area, and the Rioja area in Spain (and linking our dataset to a price dataset describing the dynamics of price over a 7-years window), we test key implications from our model. We find that prices become more related to Parker notes as a by product of this increased demand for wines of proven quality. Second, we also find that a change in Parker note has a stronger effect on prices the stronger is the reputation. This comes from the fact that reputation is more and more valuable, and therefore a bad signal has a stronger negative effect on prices.

This paper extends the previous work by Tapia and Warzynski (2007) by taking a deeper look at the effect of globalization and the superstar effect. They looked at the effect of a change in the opinion of a wine expert, on price and linked this reaction to the level of reputation enjoyed by the firm. They tested the following result: is the sensitivity of price to performance going to be different according to the level of reputation enjoyed by the vineyard? To test this idea they looked at the dynamics of performance of all wines rated by Parker in the Bordeaux area and related it to the dynamics of prices charged by the

vineyards. Performance should have a different impact on expected ability according to how much "reputation" agents have accumulated. Reputation is usually considered to build gradually through learning, i.e. after observing past performance. To our knowledge, only a few papers have investigated this issue in different contexts. Cabral and Hortacsu (2005) and Jin and Kato (2005) looked at the dynamics of reputation in eBay auctions, and Jin and Leslie (2003, 2005) looked at reputational effects of the introduction of hygiene cards in Los Angeles' restaurants.