Role of current quality and regional reputation in wine pricing

Omer Gokcekus
John C. Whitehead School of Diplomacy and International Relations, Seton Hall University, USA

Abstract

Wine is an experiential good: Until you buy and taste it, you won’t know how good it is. Therefore, as risk-averse individuals, in addition to “current quality” of a particular bottle of wine, wine buyers pay attention (or pay premium) to the overall “regional reputation” of the area a particular bottle is coming from. In this study, we first built a formal wine pricing model as a function of both current quality and regional reputation. Second, we empirically tested the validity of this model by using the wine prices and discount rates from a large wine retailer in New Jersey, USA.

In setting the model we assume that, given the number of bottles produced, a winery maximizes its profits by selling all of them within a year. (At the end of a year they need the storage space for the next year’s crop/wines.) Accordingly, maximizing profit is equivalent to maximizing revenues. In the first period, a winery sets a price for a bottle based on its current quality and its regional reputation. During the first period, wine drinkers try wines, find out that there are “good quality” wines coming from “less” reputable regions, and with word-of-mouth and other means of communication, e.g., wine blogs, dinner tables, they share information among themselves. Effectively, demand for good wines from less reputable regions goes up and they sell “more.” At the beginning of the second period, to sell all of the remaining bottles, wineries cut their prices. Because of the “word-of-mouth effect,” newcomers need a smaller discount than incumbents to sell their remaining wines.

Based on (1) initial retail prices and discounts applied in the middle of a year for 289 wines from 17 different regions (or countries); (2) either Wine Spectator’s or Wine Advocate’s (or a combination of both) rating of each bottle of wine; and (3) ratings of these regions’ or countries’ reputations as determined by 12 different wine experts (mostly the members of the Editorial Board of the Journal of Wine Economics), we conduct empirical analyses. Our preliminary regression results indicate that (1) there is indeed a significant premium derived from the reputation of the region a wine comes from, in addition to the premium for the quality of a specific bottle of wine, e.g., its Wine Spectator rating; and (2) wineries from regions with better reputations end up cutting a higher percentage of their prices.

* Omer Gokcekus, School of Diplomacy and International Relations, Seton Hall University, S. Orange, NJ 07079, USA; tel.: 973-313-6272, fax: 973-275-2519, e-mail: gokcekom@shu.edu.