

## Difference between the Cost, Price and Value of Wine

By PM Patrick McHugh Chair of Wine Committee October 2019

Steven Spurrier wrote in his fascinating autobiography *Wine a Way of Life*,<sup>1</sup> that 'wines are meant to be shared long after the cost of purchase has faded'. What he meant by this is the subject of this article because there are major yet subtle differences between the cost, price and value of wines which are important to understand in setting the strategy for the Company's wine cellar. What are the differences between cost, price and value?



Come and sit down with me at my table and let me open a bottle of wine<sup>2</sup>. There are many ways to go on a journey of discovery and this is mine. We'll drink together and with all five senses primed we are ready to depart.

First, we hear the abrupt exhalation of a cork, the melody of falling liquid, the chink of meeting glasses, the thud as the bottle comes back to rest on the table. These are tangible relics of my childhood and the ghostly imprint of bottles that I shared with my father, sitting at the table pouring wine, commencing an instructive commentary on the bottle we were about to share. 'Now this ...'

he would begin, and my adolescent self would immediately tune out.

But my love of wine began where that of my father ended. As a young engineer constructing the nuclear power station in Chinon on the Loire river my education in wine truly began when the landlord of my inn (a Bourgeuil vigneron) took me under his wing determined to fill in the knowledge of wine that every young Frenchman has absorbed at his family's table but we in the cold English climate have sadly missed. He taught me to drink just as I learnt to read and down the years I have found a way to continue a conversation that when my father was alive had barely begun. What is the first thing that comes into our mind whenever we drink a bottle of wine? For those of us that love wine it is another question, 'what has the wine maker set out to achieve with this wine?' and then we seek the answer to this second question as an approval rating.

Wine is alive, ageing and changing, but it is also a triumph over death. The grapes should rot, instead they ferment. What better magic potion could there be to convey us to our past? Understanding how to drink wine requires a sophisticated understanding of the arbitrage between the cost, price and value of the bottle of wine sitting on the table in front of us. By arbitrage I mean, 'the simultaneous buying and selling of wines in different markets or in derivative forms in order to take advantage of differing prices for bottles of wine'. To arbitrage successfully requires knowledge and in this article, I hope to pass on my knowledge to help you enjoy our open bottle.

<sup>1</sup> Stephen Spurrier, *Wine A Way of Life*, 2008 Adelphi Publishers,

<sup>2</sup> Much of this introduction comes from the excellent book by Nina Caplan, *The Wandering Vine – vine, the Romans and me* Blooms berry Publishing plc 2018.

Let's begin with cost, which is simply the money value of the resources involved in the production of a bottle of wine including the land, labour, capital, packaging, transportation, VAT and excise duty. Cost is the amount incurred on the inputs like land, labour, capital, enterprise, etc. for producing any product. It is the amount of money spent in the manufacturing of a product. For example- If a company manufactures shoes, then the expenses incurred on raw materials, salaries, rent, interest, taxes, duties, etc. determines the cost of the product. In the case of a bottle of wine the cost of the agricultural processes which produce the grapes is likely to be roughly 50% of the cost of the bottle of wine. In the following 2016 article<sup>3</sup> we can see the real costs of production of a bottle of Napa Valley Cabernet Sauvignon fine wine.

We will buy 2 tons of Napa Cabernet Sauvignon at the Napa Valley average price of \$6300 per ton. Total: \$12,600

We will take that to a "friend's" winery (because only a friend would mess with that tiny amount and only charge you the going rate). He will charge \$600 per ton to crush and ferment the grapes up to the point they are pressed off and the wine is in a tank. Total: \$1200

Now we have to age the wine. We will buy brand new barrels because that's what everyone else is doing and you have to compete! You will need 5 new French oak barrels at a cost of \$800 each. Total: \$4000

You will need to store those barrels, have them topped and rack the wine occasionally over the course of the 18 months of aging. If it's racked 3 times at a cost of \$200 each time and the storage cost is \$12/barrel per month that is a pretty accurate representation of aging cost. Total: \$1680

Now it's time to bottle. Let's start with the cost of the package itself. Bottles: \$12/case, Corks: \$3/case, Capsules: \$2.40 per case, Labels (fancy and not many so they will be expensive) \$8/case. Next is filtration and bottling. You have 300 gallons which will make 125 cases. Filtration will cost you \$200 set up plus \$0.60 per gallon, so, \$380 there. Bottling does not meet the minimum for most bottling lines so you are stuck paying the minimum charge of \$2000 or what would amount to \$16 per case. Total: \$5555

So, you made 125 cases and the total cost was \$25,035 or \$200.28 per case or \$16.69 per bottle.

When it comes to the UK some useful research set out in the following graphic has been done by Bibendum. The conclusion is remarkable, 'Following the recent budget announcement, as of 1<sup>st</sup> February 2019 over half the price of a £5 bottle of wine will be

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<sup>3</sup> Steve Burch an American Commercial Wine Maker in his 2016 article *How much does it cost to produce a bottle of fine wine* <https://www.quora.com/How-much-does-it-cost-to-produce-a-bottle-of-fine-wine>.

tax and just 30p will pay for the wine itself. The good news is that if you spend just a few pounds more, you get a lot more for your money<sup>4</sup>.

## VINONOMICS AUTUMN BUDGET 2018

## UK WINE PRICING UNCOVERED

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All figures are indicative, based on a "typical" bottle of wine and do not include CCT. In reality margins, packaging and logistics differ depending on the businesses and products involved, but the overall picture will still be the same. \*Average price for a bottle of wine in the UK.



But when we come to price things get more complex. Price is what you pay for goods or services that you acquire; it is clearly not what it cost to produce the bottle of wine as it is likely to have been stored for some time with a cellaring charge and opportunity cost due to the capital tied up in the wine. Price is therefore what is paid by a buyer to a seller in exchange for a bottle of wine which includes its cost and a profit margin. If you purchase a new car, then the amount you pay to the car seller for its acquisition is its price while the amount invested in manufacturing the car is its cost. Normally, the price of any goods or services is more than its cost because the price includes a profit margin. Perhaps a better definition of price is to consider the current price you would pay to bring a bottle of wine to the table. As well as, the cost of cellaring over the years and transportation price must include any wholesaler, retailer or catering mark up on the cost of wine which is often as much as 400%. Price is estimated through price policy. The pricing dilemma for winemakers and customers is well illustrated in the following article<sup>5</sup>.

LAST year, when Paul Hobbs, a California winemaker, was about to release his 1999 Beckstoffer Cabernet Sauvignon, lots of things were going through his mind. He had investments to pay off and a reputation to build on the wine, but he was also facing a market that had softened tremendously. It was up to Mr. Hobbs to determine a retail price that would let him pay off some debts and draw the attention of serious wine drinkers, yet be low enough that he could actually sell the wine, not just this year but for vintages to come.

<sup>4</sup> Vinonomics Bibendum 2019.

<sup>5</sup> Amanda Hesser. *Why Wine Costs What it Does*. April 2003.

Mr. Hobbs thought long and hard and decided: \$135.

Why does one bottle of fermented grape juice sell for \$135, and another just \$15? Americans consumed 14.9 million cases of California cabernet in 2001, according to a study by Impact, a trade publication that tracks the wine industry, and customers in a wine store, faced with walls of bottles that range in price from the low end to the high, confront the question every time they shop.

"It's definitely more art than science," said Mannie Berk, the owner of the Rare Wine Company, an importer in Sonoma, Calif. "It's finding the right point in the market where you're priced appropriately in relation to other wines that are similar in stature and style and level, where both merchants and consumers will be eager to buy the wine."

The pricing of the wines proposed by Butchers' Hall in their package for the 2019 Installation Dinner for which the Company paid £29.00 plus VAT person have been analysed in the following spreadsheet based on the retail cost of the wines found through some on-line research.

Installation Dinner P McHugh Wines Calculation								
Glasses per bottle	Fizz	7	Red	7	White	7	Port	10
Wine	Type	Retail Price per bottle ex VAT	Retail cost per bottle Ex VAT	Glasses per guest	Cost per guest retail ex VAT	Cost per guest at cost ex VAT		
Famille Moutard Blanc de Blancs	Fizz	£ 12.29	£ 6.15	2	£ 3.51	£ 1.76		
Gerard Bertrand 6ème Sens Blancs	White	£ 4.75	£ 2.37	1.75	£ 1.19	£ 0.59		
Domaine des Pourthie Cabernet Sauvignon	Red	£ 4.49	£ 2.25	1.75	£ 1.12	£ 0.56		
Barros Special Reserve Port	Port	£ 14.05	£ 7.03	1	£ 1.41	£ 0.70		
	Totals			6.50	£ 7.23	£ 3.61		
	Caterer Profit				£ 21.77	£ 25.39		
	Caterer Gross Margin				75%	88%		
Cost of package ex VAT	£ 29.00							

What this spreadsheet shows is that the caterers are making a profit per guest of between £21.77 and £25.39 on a charge of £29.00. I don't know about you but I think a gross margin of between 75% and 88% is daylight robbery!

Once we know the price of a bottle of wine, we need to turn to value which an economist would say is the utility of worth of a bottle of wine for an individual. Value is thus the usefulness of any product to a customer. It can never be determined in terms of money and varies from customer to customer. For example- If you are going to a gym and spending £100 a month, and your level of fitness is seen as worth the expense, then £100 a month is the value that you create for your gym, regarding the service being offered there. Clearly price is same for all customers; cost is also same for all customers while value varies from customer to customer.

If you are a watch manufacturer and produce millions of watches on a daily basis, then the cost of production is your prior concern and not the value of the product. You may try to achieve the economies of scale i.e. more production at less cost. Whereas in the case of the customer, the purpose for which the watch is purchased must be fulfilled irrespective of the cost incurred in its production. A customer must feel the value of purchasing the watch in terms of its price.

The value of a bottle of wine depends on the drinkers' opinion and amongst other factors is likely to be formed by consideration of the buying experience, the rarity of the bottle, the skill at matching with food, personal experience of drinking the brand, the occasion and location at which the bottle is drunk and the reputation of the wine brand and supplier. Price also plays into the perception of value, "If I made the best wine in the world and charged \$1 for it," he said, "no one would believe it was the best. They'd say it's a great bottle of \$1 wine<sup>6</sup>." The ups and downs in the market will affect the price and the cost of any product while value remains unaffected. We have seen how price is calculated in numerical terms, cost is also calculated in numerical terms, but value can never be calculated in numbers alone.

<b>BASIS FOR COMPARISON</b>	<b>PRICE</b>	<b>COST</b>	<b>VALUE</b>
Meaning	Price is the amount paid for acquiring a bottle of wine.	Cost is the amount incurred in producing a bottle of wine.	Value is the utility of a bottle of wine to its owner.
Ascertainment	Price is ascertained from the drinker's perspective.	Cost is ascertained from the wine maker's perspective.	Value is ascertained from the drinker's perspective.
Estimation	Through Policy	Through Fact	Through Opinion
Impact of variations in market	Prices of wine increase or decrease.	Cost of inputs rise or fall.	Value remains unchanged.
Money	It can be calculated in terms of money.	It can also be calculated in monetary terms.	It is not calculated in terms of money.

<sup>6</sup> Vic Motto, Senior Partner at Motto Kryla Fisher, wine industry consultant in St. Helena, California, USA.

The difference between price and value was explained easily by Prof. Adam Smith in his example of about and diamonds. Water is much important for us to survive still it is of low price, while the diamond is just used for ornamentation and nobody dies without it; yet it is priced very high. The reason behind this is value, though the value of water is much for us, it is available at a low price, while the value of a diamond is less for us it survival terms it has a high value as an artistic and cultural object and it is very costly to produce so it is priced very high<sup>7</sup>.

“What are the rules which men naturally observe in exchanging goods for money or for one another, I shall now proceed to examine. These rules determine what may be called the relative or exchangeable value of goods. The word value, it is to be observed, has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys. The one may be called "value in use;" the other, "value in exchange." The things which have the greatest value in use have frequently little or no value in exchange; on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarcely anything; scarcely anything can be had in exchange for it. A diamond, on the contrary, has scarcely any value in use; but a very great quantity of other goods may frequently be had in exchange for it”.

### **Conclusion**

After discussing a lot about these three terms, you must have found out the answers to the three questions asked at the beginning of this article. In simple words, Price is the money paid to the seller for a bottle of wine; Cost is the amount of inputs involved in the production and supply of a bottle of wine and value is what consumers consider the bottle of wine is worth. You may even have started to reflect on the advantages of value rather than cost based pricing of your Consulting Services.

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<sup>7</sup> Smith, Adam. *"Of the Origin and Use of Money". An Inquiry into the Nature and Causes of the Wealth of Nations.* 1776.