**Market Transparency and Efficiency: Fine Wine’s Online Revolution**

James Miles, Wine Future, Hong Kong, November 6th2011.

Slide 1: Title

For most of us, broadband internet is less than 10 years old. In that short period, the internet has proved disruptive for many industries. The fine wine trade is no exception. Our industry has undergone an online revolution.

Our sense is that this period of disruptive change is only just getting started.

Slide 2: Liv-ex

I co-founded Liv-ex, together with Justin Gibbs, in 1999. The vision was to provide a global (B2B) trading exchange for fine wine merchants. Twelve years on, we have over 400 members in 33 countries. In the last year, we have matched US$160m of buy and sell orders on the platform. We have three core business areas: the trading platform itself; data and research; and storage and transport.

It is fair to say that without the internet, Liv-ex wouldn’t exist.

Slide 3: Ripe for change

To fully understand the disruptions that the internet has set in motion for the fine wine trade, we should highlight the characteristics that made the sector so ripe for change.

By fine wine, I am referring to wines that are actively traded on the secondary market, are internationally recognised and have the ability to improve (and gain value) in bottle.This is a relatively small universe of wines and is concentrated in the top Bordeaux estates.

The fine wine trade has traditionally been incredibly opaque – only insiders really had access to the key information.

There was a lack of trading liquidity and it was highly fragmented, both in terms of players and products.

All of these factors made the flow of information slow and inefficient.

Slide 4: Market transparency

The arrival of the internet has brought numerous benefits to the fine wine trade, but by far the most important is transparency. This transparency falls into three key areas:

Quality: There are now a huge number of tasting note databases, peer-to-peer platforms (like Cellar Tracker) and other online forums to frequent. Finding an independent verdict on the pros and cons of any wine has never been easier, helping to demystify wine knowledge.

Availability: Most merchants now publish their catalogues online. Moreover, price comparison sites, such as Wine Searcher, allow consumers to quickly find the wine they want at the best price.

And if you are a professional trader or a serious collector and you want to know the price at which merchants are actually trading at, you come to Liv-ex. This information isn’t available anywhere else.

Slide 5: Market transparency

Just ten years ago, price discovery was time-consuming and imperfect. The only way to accurately gauge market pricing was to thumb through catalogues, hit the phones and send out faxes. And that was for insiders. Consumers and collectors had no chance. Realistically, only a handful of merchants knew what was really going on.

Slide 6:Market transparency

This is the chart for Lafite 2008 as represented on Liv-ex.com – each of those dots represents an actual transaction. In the past, gathering together this sort of detailed data simply wasn’t possible. Today it is available in an instant. And anyone who signs up to Liv-ex can view it.

Slide 7: The result

So what has been the result of this increased transparency? Clearly, the barriers to entry in the sector have fallen dramatically. With equal access to market data and easy distribution, anyone with the will and the capital can set up a reasonably competitive business.

Similarly, confidence in the integrity of the market has brought a huge amount of new money into the industry, helping to open up new frontiers and opportunities. The most obvious amongst these are new emerging markets like China.

Yes, the transparency has had an impact on margins, but it has also precipitated rapid growth.

Slide 8: Market expansion

Between 2004 and 2010, fine wine turnover quadrupled from US$1bn to US$4bn.

Slide 9: Higher prices

Over the same period, prices – as represented by our leading benchmark, The Liv-ex Fine Wine 100 Index – have risen threefold.

Slide 10: What next?

So where next?

In our view, we are still only scratching the surface as far as the internet’s potential is concerned. The next ten years are likely to be even more disruptive. But our sense is that the main changes will take place behind the scenes. It will be all about restructuring – what we call “post trade” –the supply chain and other back-office functions.

Granted this is not quite as glamorous as selling more wine, but it is where much of the residual inefficiency resides in the fine wine market and could unlock considerable future growth.

Slide 11: A post-trade revolution

We feel that there are two key issues with post-trade logistics and settlement that need addressing.

First, accounting and logistics functions in fine wine remain little changed in 20 years, despite the massive changes that we have already highlighted. In many cases, they are no longer fit for purpose and rely on expensive and unnecessary duplication of manual data entry. (We have customers who can only confirm an order after checking three different systems.) In a world in which we are all connected by the internet, this is completely ridiculous.

Second, fine wine continues to piggy-back on the commercial wine logistics infrastructure. Commercial wine is a fast-moving, low-value good, with a short, uncomplicated supply chain. Fine wine shares none of these characteristics. The internet offers the opportunity for fine wine to develop its own platform.

Slide 12: Improving systems

Tackling the systems question first, we envisage a future where there is increased data interchange between customers and suppliers. APIs running along industry-wide messaging standards will enable the automation and simplification of long-winded and expensive processes.

Transactions, invoices, warehousing instructions and accounts entries will be handled electronically via integrated systems, allowing for straight-through processing. This will improve accuracy and lower costs dramatically.

We believe L-WIN – our new Universal Wine Code – is a key part of this process. It provides a common language for the trade: one wine, one code. This may seem like a small initiative, but it could have an enormous impact on the ease of data exchange. We are greatly encouraged by its enthusiastic initial take-up. It is a free resource and available online, so if you think it might be helpful, please use it.

Slide 13: A new supply chain

As far as the supply chain is concerned, the key point to understand is that – from a business perspective –fine wine and commercial wine share nothing in common...

Slide 14: Commercial wine

Commercial wine is:

Fast moving: Wines generally intended to be drunk within eighteen months of release.

Low value: The average bottle price in the UK (before tax and distributors’ margin) was just $2 in 2010.

Short and Simple: It has a logistics infrastructure designed to get the wine from producer to consumer in the most efficient way possible.

Slide 15: Fine wine

Fine wine is the exact opposite:

Slow moving: Fine wine has a long life span of up to 50 years in some cases, like the Latour 1961 we have pictured here.

High value: The average trading price for a bottle of wine on Liv-ex in 2010 was $400 - 200 times higher than in the commercial sector.

Long and complex: Fine wine has a complicated supply chain and is mostly bought and sold many times before it gets drunk.

Slide 16: Eliminate movements

Eighty per cent of the trade on Liv-ex is in wines from the last ten vintages; more than half is in wines that are less than five years old. As such, the vast majority are not being purchased for immediate consumption. They are moving from one storage account to another.

This is unbelievably expensive, risky and detrimental to the provenance and condition of the wine.

So unless the wine is going to be consumed, why move it?

Eliminating excessive movement of stock provides huge upside for the trade.

Slide 17: What is the answer?

We believe that the best way forward is to reorganise the supply chain along central depository lines.

Put simply, a central depository is a mechanism for storing and managing ownership records in multiple locations.

It allows for ownership to be transferred via database transfer –rather than having to actually move the wine from country to country or warehouse to warehouse. This offers huge upside.

Slide 18: The benefits

Cost and risks (of damage, loss and theft) would be reduced.

Transactions could be completed faster, improving working capital cycle time.

And by keeping an electronic record of the storage and transport history, provenance would be improved.

This would be a win-win-win for producers, the trade and consumers.

Slide 19: To conclude

So in summary, the revolution in transparency is well advanced, but the potential gains from reorganising the post-trade infrastructure could be even more important. Thank you.