ART ADVISORY 101

Module 1 – Art Market Fundamentals

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The art market has seen many changes over the past 20 years, including a democratization of information through technology and the rise of art as an investment asset and financial tool. Collector tastes evolve continuously. As a budding art advisor, you want to make sure you know the ins and outs of the international art market.

In this module we will discuss art market fundamentals and what they mean for you and your business.

Learning Objectives

Participants will gain an understanding of:

1. The structure of the art market
2. The rise of art as a financial asset
3. The opaque nature of the art market
4. How art advisors provide value
5. Best practice and why you need it

1. The Structure of the Art Market

1.1 From national to global

1.2 Primary vs secondary market

1.3 Many different submarkets

1.1 From National to Global

- Read TEFAF Art Market Report 2017 and Art Basel Art Market Report 2017
- Size of the global art market in 2016 was between $45 to $55 billion
- Top 3 Countries according to annual sales volume are the US, UK and China
- The art market has evolved from national (New York, London, Paris) to global
- China has become a big player, pushing France out of the Top 3
- Result: art advisors have clients in more than one geographical area

1.2 Primary vs Secondary Market

- The primary market concerns the first sale of an artwork; passing title directly from the artist to a collector.
- The secondary market comprises any sales subsequent to that first sale. Includes contemporary artworks but also any older works that you run into.
- Primary market transactions mainly concern assessing the artwork's aesthetic, art-historical and monetary potential.
- Secondary market transactions also involve valuation, due diligence to establish title, authenticity or condition issues.

1.3 Many Different Sub-Markets

- The art market is not just one big market. It consists of many different submarkets determined by style, philosophy, period, geography or medium.
- These sub-segments, even the markets for specific artists, have their own economic cycles and characteristics.
- As an art advisor you want to be specific. In your work, you are not necessarily interested in how the entire art market performed against the S&P 500.
- If, for example, you research the purchase of a painting by Claude Monet (1840-1926) you are interested in the Impressionist market and the market of Monet in particular.

2. The Rise of Art as a Financial Asset

2.1 From passion purchase to investment

2.2 Pros and cons of art investment

2.3 Art as a financial asset

2.4 Consequences for art advisors

2.1 From Passion Purchase to Investment

- Until the late 20th Century, art collecting was done mostly for intellectual or aesthetic purposes.
- Most important change of the 20th Century is that art is now viewed as a financial asset.
- With that changed perspective on art, as well as collector's behavior.
- Most collectors buy art because they love it, but these days they also want to make a smart investment decision.
- What are the pros and cons of art investment?

2.2 Pros and Cons of Art Investment

PROS

- Art is a tangible asset, like real estate
- Good quality art tends to hold its value (inflation hedge)
- Asymmetry of information has advantages for experienced collectors

CONS

- Art is an illiquid asset when compared to stocks
- It can take a long time to sell an artwork
- Art is a complex asset to appraise
- Risky from a title and authenticity perspective

2.3 Art as a Financial Asset

- Art may not be an ideal investment opportunity for every collector, but art is certainly a financial asset.
- Art ownership can generate tax and legal consequences, for example estate taxes when a collector passes his collection to his heirs and capital gains taxes when a collector sells an artwork.
- Art is used as a financial tool: for example, as collateral in art loans.

2.4 Consequences for Art Advisors

- The shift from passion purchase to financial asset has two consequences for art advisors.
- Firstly, explain to potential clients that art is not necessarily a great investment opportunity and why. You cannot guarantee rates of return.
- Secondly, you need to have a working knowledge of art and finance instruments, such as art loans, as well as the legal and tax consequences of art ownership, conservation and art asset management.

3. The Opaque Nature of the Art Market

3.1 The Lemons Problem

3.2 The art market is fragmented

3.3 Technology improvements

3.4 Informal character of the art market

3.5 Unregulated: the Wild West?

3.1 The Lemons Problem

- How does the opacity of the art market affect collectors and why is your role as art advisor so important?
- In a way, buying a painting by Pablo Picasso is similar to buying a Park Avenue condo in New York City or investing in the stock market.
- Unless your client is a seasoned New York City real estate broker or a savvy stock-picker, it's easy for them to overpay.
- Art collectors are dealing with the "Lemons Problem", a term coined by George Akerlof, an economist and professor at the University of California, Berkeley.
- Asymmetry of information in a market: insiders (or sellers) know significantly more about the asset, product or service than consumers (buyers).
- This leaves art collectors exposed to the possibility of buying a "Lemon" (an overvalued condo, an inflated stock or a painting with authenticity or condition issues).

3.2 The Art Market is Fragmented

- Small number of large auction houses and galleries, but most art businesses are small and specialized in niche markets.
- According to the TEFAF Art Market Report 2017, in the US alone 'roughly 75% of commercial galleries and art dealers are run as sole proprietors'.
- This makes it very difficult to collect information about these small businesses, let alone price data for individual art transactions.
- According to the same TEFAF Report, as much as 62.5% of the entire global art trade in 2016 was conducted through dealers and galleries, the remainder through public auctions.

3.3 Technology Improvements

- Technology has disrupted the real estate market (Zillow), the travel industry (Expedia) and market for used cars (Carfax).
- In the art market, companies like artnet.com make auction records available online to collectors and art market professionals for a fee.
- 62.5% of art transactions is done through dealers and galleries.
- Online aggregators like artnet.com are only able to provide access to 37.5% of annual price data (auction records).
- Collectors have access to less than half of all price data. Additionally, auction data also tends to be positively biased.

3.4 Informal Character of the Art Market

- The art market is informal. Transactions aren't regulated or not even necessarily recorded.
- Many collectors do business based on a handshake basis with galleries and dealers they know and trust.
- This discretion benefits experienced collectors and dealers (the insiders), but it is a major problem for collectors who are just starting out in the market.
- The opacity of the market facilitates conflicts of interest, hinders price discovery and it makes it very difficult to determine title and authenticity issues.

3.5 Unregulated: The Wild West?

- Many laws and regulations exist that affect art collectors and art market professionals.
- Unregulated refers mostly to professions. Dealers, gallerists and art advisors do not require certificates or licenses.
- The art market does not have a regulatory body that regulates the behavior of individuals and companies.
- However, organizations like the AAPA and the AADA have established Codes of Ethics.
- The opacity of the art market, its unregulated nature and the complexity of valuing art correctly can make a new collector's life very difficult.
- A collector needs an insider who acts on his behalf. This is where you come in.

4. How Art Advisors Provide Value

4.1 A collector's key ally

4.2 Provide education

4.3 Reduce a collector's transactional risk

4.4 Manage a collector's art assets

4.1 A Collector's Key Ally

- As an art advisor, you are your client's key ally in mitigating their "Lemons Problem".
- The role of dealers, gallerists and auction house experts is to bring deep expertise to the market.
- As an art advisor you act as your client's advocate and you process this expertise to your client's benefit.
- In fact, galleries and auction houses like working with good art advisors.

4.2 Provide Education

- Emerging collectors who just started to collect art usually don't know the art market yet.
- You will help your clients to understand how art is valued and appreciated, and you will educate them on the art market and on art etiquette.
- You'll be able to give your clients access to off-market opportunities, provided that you've built your network.

4.3 Reduce a Collector's Transactional Risk

- It's easy for a collector to overpay for a work. A collector may not always make a rational purchase decision. Perhaps they simply fell in love with the work.
- Auction data is now available for collectors but this information does not provide all the answers.
- When a collector has conflicting motives (investing vs pleasure) and a lack of reliable price points, too much can be paid.
- Your job is to help your client make smart purchase decisions so that they don't lose out financially.
- It's also your job to steer your clients away from buying problem works (title, authenticity, or condition).

4.4 Manage a Collector's Art Assets

- Art does not just lose value as a result of market fluctuations but also as a result of physical deterioration.
- Arranging insurance coverage, appraisals and conservation treatments, researching the collection and keeping track of vital documentation is part and parcel of what an art advisory team does.

5. Why You Need to Follow Best Practice

5.1 Managing expectations

5.2 Disclosure

5.1 Managing Expectations

- It is easy for misunderstandings to arise between collectors and their art advisors.
- A direct result of the art market's idiosyncrasies: a lack of price transparency, unregulated professions and a complex asset to appraise.
- Three ways to protect the relationship with your client: managing expectations, disclosing your remuneration and potential conflicts of interest and lastly, conducting your business and charging in a professional manner.
- I will discuss managing expectations as well as contracts and fee structures in Modules 3 and 5. I will address disclosure here.

5.2 Disclosure

- The unregulated nature of the market allows for hybrid business models and makes it easy for art advisors to start a business.
- However, the purpose of an art advisor is to mitigate their client's "Lemons Problems". You can't do that if you don't act as your client's fiduciary. When you operate as an art advisor you should put your client's interests before yours.
- This means that you have to be transparent on remuneration, avoid conflicts of interest and be completely independent in your advice, which means no referral fees from auction houses or galleries.

End of Module 1

That concludes Module 1 of Art Advisory 101.

Up next is Module 2 - The Drivers of Value in Art!

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