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Auction houses: Troubleshooters

John Gapper and Elizabeth Paton

Beyond the record art sales, Sotheby's and Christie's new chief executives must draw up plans to reinvigorate both groups


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The 75,000 hedge fund managers, oligarchs, wealthy family scions, gallery owners and hangers-on who throng the Art Basel Miami Beach show had much to talk about this week as they converged on Florida for the festival. While obeying ArtNet's tongue-in-cheek rules for attendance ("Make sure to be seen munching $20 sandwiches and stay close to the Ruinart Champagne trolley"), they could chat about the upheaval at the leading auction houses.

On Tuesday, the art world was taken by surprise by the resignation of Steven Murphy, chief executive of Christie's. Mr Murphy had just presided over a record-setting contemporary art evening auction in New York, at which the house sold $853m of works, including $81.9m for Andy Warhol's "Triple Elvis (Ferus Type)", a portrait of the rock 'n' roll singer dressed as a gunslinging cowboy. The era of the billion-dollar auction is tantalisingly close.

His abrupt departure came only 12 days after the resignation of William Ruprecht, the oriental carpet specialist who had led Sotheby's for 14 years. That announcement was less of a shock. He had been under pressure from Daniel Loeb, the hedge fund manager who last year described Sotheby's as "an old master painting in desperate need of restoration".

The resignations from the houses that hold a duopoly of high-priced auctions has the gossipy art world, which loves to spin conspiracy theories from scraps of information, agog. To judge by the top line, the houses should not be troubled. In terms of revenues, Christie's in particular is having a strong run, more than recovering from the 2008 crisis. Breathtaking bids are back, especially for pop art and the abstract expressionist works favoured by hedge fund collectors.

But appearances can be deceptive. Mr Murphy's resignation raises questions about whether he paid too high a price for rapid growth in his four years at the helm, squeezing profits by expanding into India and China, while competing intensely for prestigious sales by offering guarantees and side deals to entice family estates and wealthy sellers. The irony of the art auction world is that the record-setting London and New York auctions for which they are best known can produce little, if any, profit.

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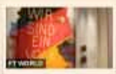
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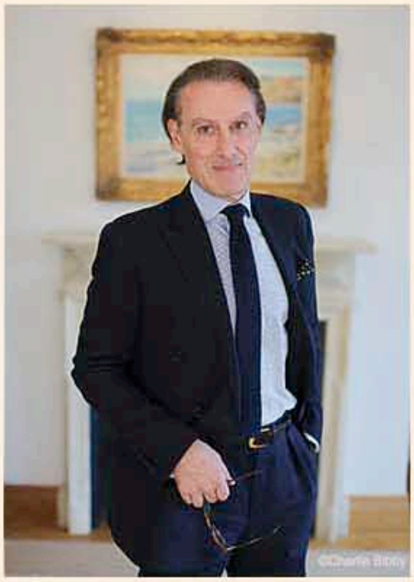
"It has increasingly become the case that these types of sales — for both houses — are not centres of profitability in any way," says Michael Plummer, co-founder of the New York-based advisory firm Artvest. "The competitive pressure gets worse every year, as do the amount of guarantees, and consequently the risks for both houses."

Mr Ruprecht was fiercely criticised by Mr Loeb before the latter joined the Sotheby's board in a peace deal in May, for allowing Christie's to take a lead in contemporary art, and for being complacent. Now, analysts wonder whether Mr Murphy, an outsider to the art world who had worked in the music and publishing industries, was too spendthrift for the comfort of François Pinault, Christie's majority owner.

Christie's insisted this week that both revenues and profits are healthy. It reported a record first-half performance in June with sales of £2.7bn but, in keeping with tradition, it did not disclose its profits. "The rivalry between the two houses is based on a relentless game of brinkmanship, one that to outsiders defies common business logic," says Mr Plummer.


In the picture: Steven Murphy

"The contemporary market has been incredibly strong, but at the top level many of the sales are unprofitable," says Pilar Ordovas, former deputy chairman of contemporary art at Christie's. "The auction houses want the prestige and so they are willing to work for very little money.

The duopoly between Christie's and Sotheby's once operated in a cosy fashion. That led to the 2000-01 scandal in which Alfred Taubman, the Sotheby's chairman and chief executive, stepped down after being found to have fixed auction commissions in collusion with Christie's. Since then, the competition has been relentless, and it deepened during Mr Murphy's tenure. Some analysts say the focus on constantly setting new records makes it irrational.

"This pursuit of market share in contemporary art has got to the point where it is almost self-destructive," says Anders Petterson, a director of the London art consultancy ArtTactic. "A wealthy individual walking into an art auction has to get a sense of confidence that the sales are doing well. The whole thing is quite fragile and auction houses feel that quite keenly."

Executives and specialists believe that Mr Murphy's departure will ease the intense competition and allow the margins to expand at the top end. But that may be an idle hope. Not only could Sotheby's itself become more aggressive under a new leader, with a more ambitious board, but the auction houses do not operate in a hermetically sealed world. They have to keep proving themselves against the new breed of contemporary art "superdealers", such as Larry Gagosian and David Zwirner.

> "The auction houses want the prestige and so they are willing to work for little money"

In theory, galleries and auction houses perform different functions. Galleries are the primary market, where collectors can buy work directly from artists, through a gallerist. The big collectors can thus secure works at lower prices than when they go to the public auction market. In this sense, it is similar to investors buying shares in companies at initial public offerings, rather than on the stock market. Dealers representing big artists have galleries around the world and large inventories.

But dealers and auction houses have a close relationship, particularly in contemporary art, where the houses sell the works of the artists that the dealers represent, often setting new price levels. They are intertwined by the practice of auction houses trying to lure sellers by offering guarantees that if a work fails to reach the promised level, the auction house will pay it anyway. Barrington Research says Christie's guaranteed 34 per cent of the lots in its November sale, with total presale estimates of between $353m and $508m.

Some of these guarantees are laid off by auction houses to dealers, who try to support their own stock by ensuring that public sale prices stay at an elevated level. But although the auction houses and dealers embrace each other, they also compete for the attentions of the biggest collectors. "It is a symbiotic relationship, but the real juice is selling primary works to a guy like me, and the auction houses are not remotely in that business," says one wealthy collector.

The financial stakes are heightened further by the fact that hedge fund managers have taken an interest in the business beyond collecting. Mr Loeb, the largest shareholder at Sotheby's with a 9.6 per cent stake, has taken a seat on its board, while Jim Chanos, the prominent short-selling hedge fund manager, has taken a position against the auction house, arguing that its shares are overvalued and due for another tumble. Both Mr Loeb and Mr Chanos are collectors of contemporary art.

> "'The real juice is selling primary work and they are not in that business'"
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For now, both auction houses are intent on displaying a sense of stability. Mr Ruprecht remains in charge of Sotheby's while it looks for his successor. "It isn't just a mark of respect — it's comforting and essential for the board and all Sotheby's staff to have him here in the transition period," Domenico del Sole, Sotheby's lead independent director, told the FT. He said "the sales figures we hit this month and last month prove that Sotheby's is doing very well".

In October and November, Sotheby's reaped a total of about $2bn worth of sales.* Yet in last month's earnings for the third quarter, the company's net loss stood at $27.7m, or 40 cents per share, narrowing marginally from $30.1m, or 44 cents a share a year earlier. Mr Ruprecht's successor — the company is believed to be looking to hire from the luxury industry — will arrive with much still to be done to turn its fortunes round.

At Christie's, Mr Pinault has appointed Patricia Barbizet, a trusted lieutenant who is Christie's chairman, to become chief executive as well from January. It is trying to portray Mr Murphy's abrupt departure as normal practice in a private company, and the logical end of a four-year restructuring. Outsiders are less convinced and some expect Ms Barbizet, who is also chief executive of Artemis, Mr Pinault's family holding company, to step back when Christie's finds another chief executive.

The wider art industry is looking nervously at the broader global economy, banking on its stabilisation after fluctuating exchange rates and political instability took their toll on the fortunes of other players in the luxury sector. Experts at the auction houses hope that is true, and that the industry can settle into a more comfortable pattern. But the need to keep ahead of the superdealers suggests this will be difficult.

"There is deflation in a bull market, so God knows what happens when the next crash comes," says one investor, referring to the narrowing margins at contemporary art auctions. In Miami this week, the champagne flowed and the incredible prices paid at the Christie's and Sotheby's sales last month kept the art market in good cheer. But in an industry where images mean everything, the reputations of these two companies will be on the block next year.

**This article has been amended from the original to correct the total sales figure of Sotheby's.*

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