A model of adaptive relationship between the entrepreneur and the bank: the case of French vineyards entrepreneurs

Availability of funds is a critical question for new French vineyards entrepreneurs. Indeed, investment for grape growing, wine making and wine marketing, as compared to sales, is very large. As these new entrepreneurs free cash-flows stay rather low, their investment capacity can be strongly limited if they do not benefit from a tight relationship with their bankers. In this paper, we present the relationship between the bank and the entrepreneur as an adaptive relationship. We aim at encompassing the literature on corporate debt and investment, initiated by Myers (1977) and debt maturity and information asymmetry in the manner of Diamond (1991). In the model, we study the project value and the liquidity risks when the entrepreneur investment varies. As information interacts with short term debt maturity (thus, liquidity risks), the entrepreneur can undertake a sub-optimal investment in the first period if he expects that this can increase his probability to benefit from a reputation effect in the second round of investment. It thus optimizes the investment process. The hypotheses of a need for a larger bank support of the ‘ambitious’ wine-grower entrepreneurs, together with a continuous monitoring are verified, both theoretically and empirically. This model of bank-entrepreneur relationship appears to be relevant for small scale business with high capitalistic intensity, and therefore highly leveraged firm, found in sectors such as the agrifood business. Results therefore plead for a special place of “entrepreneurship finance” in commercial banks and the need for an expertise in different industrial and agricultural sectors, as credit scoring approaches seem irrelevant for some specific types of businesses.