

Evaluating the Risk to Invest in the Wine Industry: What Skills should the Loan Officer Possess?

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Abstract

◦*Purpose* – This paper explores the evaluation strategy the loan officers have to develop when committing to wine businesses; in particular this study focuses on the inherent risks the wine production involves and the issue information asymmetry between stakeholders.

◦*Design/methodology/approach* – The research utilises exploratory case studies and perform an in-depth analysis of a series of semi-guided interviews of loan officers of three different banks, closely working with the French wine companies.

◦*Findings* – Our first findings reveal the importance of the industry specific knowledge for loan officers dealing with wine business to be able to measure risk, balancing quantitative and qualitative information while relying on their own experience.

◦*Practical implications* – This work lays the requisite groundwork to propose recommendations on the organisation of information process and specific risk measurements to guarantee higher ROI in the wine industry.

Key words: Wine industry, financial risks, wine tourism, wine producers, loan officers

1. INTRODUCTION

Wine is a living product very sensitive to its environment at each stage: from vine growing which is dependent on climate factors through wine making and wine aging till wine delivery dependent on temperature fluctuation, humidity levels, etc. This natural sensitivity brings complexity and uncertainty that is why the wine sector is characterised by high risks. The long production process imposes financial constraints and requires frequent support for funding. Small and medium wine producers heavily rely on banks in developing their business. The role of banks' loan officers is mainly to decide the attribution of recurrent short-, mid- and long-term loans to finance as an example the stocks, the equipment or wine tourism initiatives. Their decision is crucial in developing business activities, yet it involves a real expertise in the wine industry's risks in order to prevent potential failures and guarantee solvability.

Maque and Godowski, (2009) demonstrated the complementary between amount of information and its qualitative appreciation by loan officers working with SMEs. However, their study recognises the lack of knowledge of this fine balance on the entrepreneur's side and the asymmetry of information holding.

Few examples are found in the agriculture industry, and even less in the wine industry. Thus, our study paper aims to understand how loan officers appreciate the risk of failure when committing to wine producers in Bordeaux region. Taking a closer look at the dynamic of the risk evaluation, and the exchange of information, we aim to lay the requisite groundwork to propose recommendations on the organisation of information process and specific risk measurements for practitioners and their clients.

2. LITTEATURE REVIEW

Evaluating the risk in small or medium businesses the literature focuses on predicting bankruptcy of SME's (e.g., Bredart (2014) or on forecasting difficulties (e.g. Du Jardin, 2019) The proposed models rely on an the indicators extracted from the accounting records: amount of debts, total assets, cash flow, total sales, EBIT and EBITDA, turnover etc... However, there is an important gap in the literature that considers the wine sector and its specificities concerning the production cycle which are mentioned above.

Having a closer look at the wine estates in the Bordeaux region, which represent SMEs, a few important components typical of the industry such as: value of the stocks, land value and land ownership should also be considered. Otherwise, estimation of the risks for wine businesses is incomplete in the case of classic SMEs' financial models.

The main inherent risk is the climatic risk, causing some years the complete loss of the annual production, such as the two recent main episodes of frost in 2017 and 2019 in Bordeaux area ¹. The frequency of these climatic accidents has increased in the past decade and are correlated to global warming (e.g., Van Leeuwen et al., 2019).

¹ Source : <https://www.sudouest.fr/economie/agriculture/gel-printanier-dans-le-sud-ouest-2017-et-2019-les-deux-derniers-grands-precedents-2074631.php>

In many wine regions AOC specifications involve aging of the wines, generating mid-term loans to finance the barrels, buildings, and stocks. The value of these stocks may evolve in time differently depending on quality of the final product.

SME's the company's asset is often uncoupled with the economic performance due to the value of the producing lands (Lemarié-Boutry, 2016). To ward off these specific risks, more and more independent wine producers are looking at diversifying their activities, including new distribution networks and new way to reach out to the customer (Alonso et al., 2015; Remeňová, 2018). Wine tourism is one of their option, but this opportunity generates needs of funding (Faugere and Bouzdine-Chameeva, 2013).

Based on the fact that the current developed models are uncomplete and not adapted to the specific aspects of the wine production, how do investors such as loan officers evaluate the risk of wine production businesses and the feasibility of business activities' development (e.g., diversification into wine tourism)?

3. RESEARCH DESIGN

A series of 17 semi-guided interviews with loan officers specialised in French wine estates accounts form the ground of this study. Data were collected in three banks located in Bordeaux and Cognac regions in 2021.

The following elements were approached during the interviews: the profile of the loan officer, their portfolio description; their relationship with the wine industry clients; the decision-making process to support an investment; their position facing the difficulties of their clients and their opinion on diversification of the activity such as developing wine tourism.

All the interviews were recorded, transcribed, and a text analysis has been executed.

4. PRELIMINARY FINDINGS

Despite their difference of size, commitment to the agriculture industry, and market share, all the three banks decided to detach the wine producing clientele in a special business unit, agreeing on the need of specialisation of the loan officers to serve this specific sector. The results to be presented include: the personal motivations of the loan officers, the specificities of the sector and the quality of the relationship with wine producers; trust-based relationship; a particular decision-making process to support an investment project with the specific indicators; conflicting opinion on wine tourism seen as a great opportunity but reluctant to fund this activity.

5. CONCLUSIONS

The first results enable us to build a quantitative database to list the main determinants the loan officers use to evaluate the risk of investing in wine business and prevent the information asymmetry.

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