Strengthening the Champagne Industry: Improving Risk Transfer for the Récoltant-Manipulant

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ABSTRACT:

The focus of this paper is on how to make the champagne industry economically stronger by introducing and applying financial innovations that have been successfully used in other industries.

I. Risk Transfer Opportunities

The paper is divided into five sections. The first discusses ways to improve risk-transfer opportunities and thereby reduce the industry cost of capital for the Récoltant-Manipulants, while not increasing the amount of equity risk capital needed. Financial contractual agreements can provide a means of transferring production risks of the business to investors without issuing equity in the business to outside investors.

II. Two Financial Innovations that can be implemented for Better Risk Transfer

1. The first innovation is the application of market-proven, financial contractual agreements that provide a non-equity means of transferring to outsiders the pre-harvest risks of the champagne business.

2. The second innovation is the creation of a new asset class in champagne to provide a non-equity means of transferring the post-harvest risks of the business to outside investors.

Benefits of the risk-management innovations apply to all producers but Récoltant-Manipulant champagne houses, which do not have diversified business activities, will benefit disproportionately because they do not have access to public equity markets, and do not want outside equity holders. The Récoltant-Manipulants will be able to continue or even expand operations if they so choose, because of their new ability to reduce their risks and hence to create more debt capacity to finance growth without issuing equity.

This proposed new enterprise is itself a derivative from the champagne business and not a direct part of it. However, its viability has a direct implication for the feasibility of efficient and effective risk-transfer of the post-harvest risks faced by Récoltant-Manipulants. The proposed enterprise therefore serves a dual purpose in advancing the risk-transfer capabilities for Récoltant-Manipulants, and enhancing diversification opportunities for investors.
III. Showing the Benefits Investors can provide to the Champagne Industry, Specifically to the Récoltant-Manipulants

The inclusion of champagne in an investment portfolio would benefit the entire supply chain regardless of the size and scope of the place within the supply chain, including sellers of champagne from the Champagne region. Investment on a systematic and regular basis as opposed to sporadic, intermittent investment permits transfers of material risk from the champagne-producing body to better-diversified holders.

The paper describes four types of risk-transfer investments at different points in the process: i) before the harvest, when an investor take a position on harvest risk. ii) after the harvest, when the vintage is produced and goes into barrels or tanks and an investor takes a position on the pre-bottling risk as the quality of the harvest is evaluated. iii) once the champagne is in the bottle, at which time there will be a better understanding of the characteristics of the vintage. iv) when the bottles of champagne are sent to the marketplace. To achieve the most favorable economic outcome for the Récoltant-Manipulants they would have to consider the economic forecasts for demand and the greater macro economic conditions in the marketplace. However, the risk-transfer processes presented here do not depend on their undertaking such forecasts in order to reap the benefits.

All three investment types benefit the Récoltant-Manipulants by ensuring that they can stay in business with less risk capital and run more efficiently by employing external risk transfer. In order for these to be implemented new financial products must be designed and built. A design for a product to provide effective pre-harvest risk-transfer for the vintage could be built using market-proven financial technologies such as weather derivatives whose payoffs are based on the daily temperatures and rainfall. Such a development would disproportionately benefit the limited-capitalized Récoltant-Manipulants because they can’t sell shares and therefore cannot lay off their risk in the equity markets. Instead they could use contractual agreements to hedge risk. If such an investment risk-hedging vehicle were available they wouldn’t need as much equity capital as “cushion capital” to cover losses if things go wrong. These new hedging vehicles would reduce the cost of limitations on capital and would level the playing field for the smaller producers relative to large producers who have access to external risk capital from the equities market.

IV. Analysis of the Qualitative and Quantitative Risk and Return Profile

From a risk point of view champagne is a subset of the larger wine industry. However its unique value properties distinguishes it as an investment. The paper provides a performance comparison of returns from investing in a hypothetical champagne index versus-

1. The S&P 500 Index, which represents an equity based risk asset class
2. The S&P 600 Small-Cap Index, which represents a more aggressive equity asset class
3. 2-Year Treasury Bills Index, which represents the risk-free rate
4. The GSCI (Goldman Sachs Commodities Index)
5. The CRB Index (Commodity Research Bureau Index)

V. The Best Investor-Group Profile

The question of for whom this investment proposition is best suited, either an institutional or individual investor, is then evaluated. There are limits such that these investments may not be scalable enough to support the interests of large or multiple institutional investors. Thus, we conclude that the high net worth investor should be the target. Furthermore, investing in champagne added attraction to an individual investor since it offers an interesting topic of conversation, has a residual consumable value [“redeem in-kind and drink your investment”], and other non-pecuniary benefits that institutional investors would probably not value.