Champagne wineries facing increasing costs and stagnant sales
Risk of debt distress?
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Objectives: The paper focuses on the solvency of Champagne wineries and assesses whether their financial effect of leverage is positive or negative, as some trade unions currently worry that some are risk of debt distress.

Problem statement: Most research works on the 10 largest Champagne wineries have focused on marketing and profitability, but not on financial risks.

In November 2017, trade unions of Champagne wineries expressed they worry that major Champagne wineries be at high risk of debt distress (“L’Union”, 26 November 2017 page XVI). The Champagne Committee provides economic data about the Champagne business to motivate the need for research. Over the last decade, Champagne sales in volumes have declined by 9.4% from 339 million bottles in 2007 to 306 million bottles in 2016. In value, they increased by 3.35% from 4.56 million euros in 2007 to 4.71 million euros in 2016.

However, the price of grapes has increased by 15.46% from 5.11€/kg in 2007 to 5.90€/kg in 2016. So, Champagne grape price increased a lot more than the sales of Champagne in value. Since grape costs account for more than 70% of Champagne wine costs, the profitability of Champagne wineries is at stake.

Hypothesis to be tested: Hypothesis to be tested: Some major Champagne wineries are at risk of debt distress.

Theory about the financial effect of leverage: Financial leverage magnifies the rate of return on equity (ROE) when the returns from the economic asset more than offset the costs of borrowing (Berk & de Marzo, 2017; Quiry & Le Fur, 2018). Losses are magnified when the opposite is true. A corporation that borrows too much money might face bankruptcy risk or default risk during a business downturn, while a less-levered corporation might survive.

Equation (1)

\[ \text{ROE} = (1 - \text{tax}) \left[ \text{ROA} + (\text{ROA} - r_d) \left( \frac{D}{E} \right) \right] \]

where:

- ROE is rate of return on equity
- ROA is the rate of return on operating assets
- \( r_d \) is the cost of debt capital, that is the interest rate faced by the company
- \( E \) represents the equity capital of the company
- \( \text{tax} \) is the corporate tax income rate
- \( D \) represents the financial debt capital of the company
- \( A \) represents the total operating assets of the company with \( A = E + D \)
- \( \left( \frac{D}{E} \right) \) is the debt to equity ratio, also called the gearing of the company.

When interest rate \( r_d \) is greater than the rate of return on operating assets (ROA), then the rate of return on equity (ROE) for shareholders strongly decreases as soon as the company increases its debt to equity ratio, increasing bankruptcy risks.

Data: Population studied: the top-ten Champagne wineries will be analyzed. Financial data from 1996 to 2015 come from Orbis data bank.


Key words: Champagne, wine, leverage, strategy, performance

JEL codes: G31, G32, Q14