

## SECȚIUNEA XII: EVOLUȚII PE PIETELE FINANCIARE

### RISK OF INVESTING IN COMPANIES IN THE WINE INDUSTRY OF THE REPUBLIC OF MOLDOVA (RISCURILE INVESTIRII IN COMPANIILE DIN SECTORUL VINICOL DIN REPUBLICA MOLDOVA

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*Rezumat.* Proiectele de investiții se referă la perioada viitoare de timp, de aceea este problematic de a prezice cu încredere rezultatele implementării lor. Implementarea strategiilor contra risc sunt influențate de multe schimbări în mediul politic, social, comercial și de afaceri, schimbări în tehnologie și productivitate, starea mediului, impozitarea actuală, inflația, aspectele legale și altele. Aceasta determină prezența unui anumit risc în proiecte. Industria vinicolă nu este o excepție și fiind dat faptul conține riscuri specifice doar pentru această industrie sau riscuri comune pentru orice sector.

*Cuvinte cheie:* sectorul vinicol, investiție, risc, rata dobânzii

**JEL Classification: D24, G32, L66**

#### 1. INTRODUCTION

With global wine consumption steadily rising, investing in wine stocks can give one significant returns in the long run. While wine stocks are no different from other dividend stocks, they also benefit from the growing demand but finite supply of wine. Even in times of economic strife, demand for wine has consistently outstripped supply, making it the perfect investment.

According to a recent report, the global wine market is predicted to grow with a Compound Annual Growth Rate (CAGR) of 5.8% for the forecast period 2019–2024 [9]. The Republic of Moldova wine sector is one the biggest jobs generator, 29 679 legal entities are involved in this sector of the economy. Despite its possible difficulties, the Moldovan wine industry offers great opportunities to investors. At the same time, following the 2008 financial crisis, investors have become much more cautious about their activities – even more so as a result of the market volatility and interest rates evolution for the last decade. Thus, in situation, when investments in wine industry have a lot of advantages, they imply several risks as well, which could be taking into consideration and well estimated.

#### 2. LITERATURE OVERVIEW

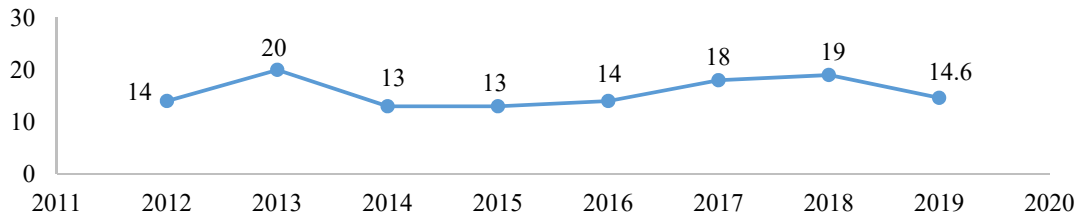
The analysis of different approaches regarding the risk concept is characterised by a large variety of theoretical and applicative definitions, which started being studied under different aspects in late XIXth – early XXth centuries. Financial risks are an integral part of entrepreneurial activity in a market environment [1]. It is nearly impossible to make up some recommendations of risk of bankruptcy analysis or/and assessment in entrepreneurial activity without knowing the justified essence of risk concept. A. Damodaran **define risk as “uncertainty about future returns”** [1]. P. Hizrici claimed „The term risk in entrepreneurial activity has spread over during the XVIIth century, when the person who signed a contract with the state for a service or labour was called „entrepreneur” [2].

#### 3. PROPOSED RESEARCH METHODS

This article is based on such research methods as: graphical method, documentary method, data method, method of synthesis and comparative analysis method. Analysis are found on the data obtained from *Decanter Journal* and *National Bureau of Statistics*.

#### 4. RESEARCH OF EMPIRICAL ASPECTS

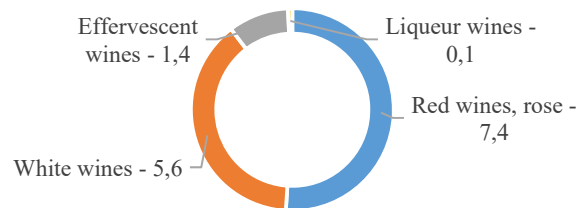
The empirical aspects identify key indicators which could reveal a clear image of the industry as a whole. There are 187 wineries registered in the Wine Register, out of which 68 possess own vineyards. Thus, the wineries own 36% of the total vineyards area, with an average surface of 220 hectares per winery. In 2018 investments amounted to \$20 mln. of which \$10.5 mln. were allocated for vineyard planting, \$4.7 mln for the modernization of wineries, \$1.7 mln. for the development of markets and \$0.23 mln for various viticulture development programs. The production of wine is currently in a positive trend line (figure 1).



**Figure 1:** Volume of wine production (mln, dal), 2012-2019

Source: Elaborated by the author based on the information from wine-and-spirits.md

Compared to critical 2018, when 19 mln. dal of wine were received, in 2019 the situation leveled off due to a smaller volume of wine from the last harvest - 14.6 mln. dal. For comparison, the average level of 2012-2018 was 15 mln. dal. During 2019, the industry produced a variety of red, rose, white, effervescent and liqueur wines (figure 2).



**Figure 2:** Volume of wine production (mln, dal), 2019

Source: Elaborated by the author based on the information from wine-and-spirits.md

Out of the volume of produced wine in 2019, 51% of the total volume is red and rose wines, 38% - white wines, 10% - effervescent wines and 1% - liqueur wines. While wine companies can be considered as good objects for investments, there are several key issues with investing in them. The most important issue is investment risks, which comprise: exchange rate risk, limited resources, unfavorable weather, tax changes, interest rate' fluctuation and other unpredictable factors.

##### a) Negative fluctuation of exchange rate

The financial results of the wine companies are subject to the exchange rate fluctuations of the EUR and USD currencies against the local currency (MDL). The evolution of American dollar recorded 12.06 USD/MDL in 2013 to 17.71 USD/MDL in 2020, while Euro was 15.99 EUR/MDL in 2013 to 19.27 EUR/MDL in 2020. The companies manage its exposure to the risk of the exchange rate fluctuation in a limited way and there is no "hedging" type agreement at the market level intended or implemented to cover this risk. Also, given the fact that the Republic of Moldova is a restrictive market that does not effectively offer sufficient liquidity and instruments to cover the risk of the exchange rate. However, the companies' efforts to cover this risk have not implemented cash pooling, treasury or similar arrangements.

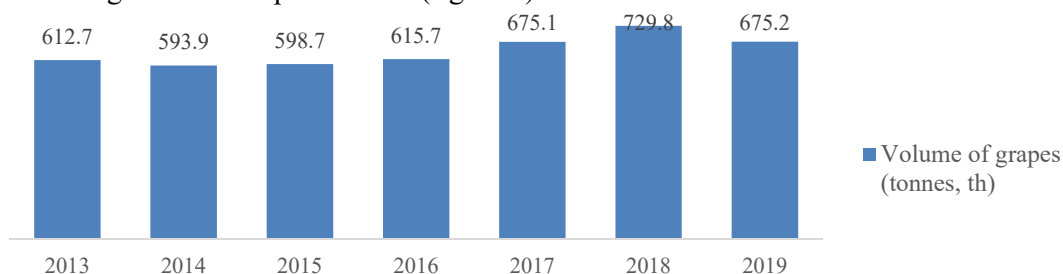
##### b) Scarcity of own resources and issues with additional ones

Companies may need to raise additional funds in the future for investments or acquisitions of companies, as well as developing their brands or products. Attraction of additional funds may not be available under acceptable conditions or may not be available at all. If they raise funds by issuing shares, shareholders may suffer a dilution of their participation. If the companies raise funds through

the issuance of bonds or by obtaining loans, the terms of those bonds or financing agreements may include commitments or other restrictions imposed on the activity of the companies and would also impose to cover additional costs with interest. For now, companies have to finance themselves mainly through debt instruments. Some, like *Purcari Winery* are listed on another stock exchange (Bucharest Stock Exchange), other local wineries' stocks are traded on the MTF platform, examples being *Kazayak-Vin S.A* or *Fabrica de vinuri Slobozia Mare S.A.*

**c) Weather as a negative factor for grape cultivation and collection**

Grape production and their quality can be affected by adverse weather events, including late frost, lack of sunlight during the flowering period, lack of rain and hail. Although the companies have implemented measures to reduce to a certain extent the risks associated with the late frost phenomenon, there are difficulties in reducing the impact of the hail phenomenon due to its unforeseen nature. For example, in 2014-2015 a significant part of the industry's production was lost as a result of significant hail phenomena (figure 3)



**Figure 3:** Volume of grapes collected, 2013-2019

Source: Elaborated by the author based on the information from National Bureau of Statistics

As could be seen, the volume of grapes decreased in 2014-2015, but quickly started to rise in the next years. Despite the fact that companies take certain risk mitigation measures, such as purchasing grapes from third-party producers and geographically expanding their vineyard culture to protect themselves from the local impact of weather conditions, the risk of future production grapes to be affected by adverse weather can not be eliminated. To the extent that the quantity or quality of future grape production will be affected by these factors, the operations of the companies could be adversely affected.

**d) Tax increases, adverse effect for the companies' product demand**

Wines and spirits are subject to excise duty and other taxes (including VAT) in most countries where companies operate. Governments could decide to increase such taxes. The demand for the products of the companies is generally sensitive to the fluctuations of the excise duties, given that in general the excise duties represent an important component of the selling price of our products in some of the main markets on which the companies operate. The regime of excise duties and taxes applicable to the operations of the companies could have the effect (and had such an effect in the past) of temporary increases or decreases of the income that are dependent on the moment of any changes in the excise level.

**e) Risks regarding the change in interest rate**

Companies are facing commercial risks arising from the monetary policy decisions of central banks. Any increase in the interest rate could have significant negative effects on the company. In recent years, central banks around the world have engaged in a series of unprecedented quantitative easing monetary policy measures, which consist of the central banks' acquisition of government securities and other securities held by commercial banks or other private sector entities, in order to stimulate the economy by increasing the amount of liquidity available to banks, so that they can grant in turn loans to entrepreneurs. However, some central banks have already turned in the opposite direction and have begun to gradually tighten monetary policy, with other banks expected to follow the same approach. For example, if the NBM will subsequently increases the reference interest rate from 3.25% in March 2020 to 3.50% in 2013, or 19.50% in 2016 and above. If this happens, it will increase the cost at

which the companies can obtain new financing and can refinance their existing debts. Therefore, if central banks begin to tighten their monetary policy, companies could be significantly adversely affected.

**f) COVID-19, an unexpected threat for wine consumption**

With new outbreaks of the Coronavirus rippling through the Republic of Moldova, the restaurant and hospitality industry has been hard hit. Many more people are staying home to dine and cook so while the wine retail sector may benefit restaurants and brasseries do not. Wine is not recession proof, but it is recession resistant. There is no chance there will be sweeping abstinence as a consequence of the virus. Restaurants are seeing fewer diners, and hotels are experiencing declining reservations and cancellations. Canceled conventions, concerts, cruises and sporting events will also reduce serving occasions and consumption, as will the impact of fewer attendees to public events that aren't rescheduled. Despite other bleak news, it is expected an increase in wine consumption at home, an increase in food and alcohol supplies on the same day, and a higher level of online wine sales from retailers and small wineries that promote their online options.

**5. CONCLUSIONS**

The Moldovan wine industry offers many possibilities and has high possibilities for growth, it still has its own problems and risks that should be solved or cannot be avoided. While the change in interest rate or exchange rate is a sudden thing but with right monetary policy, it could be mitigated, however such unpredictable factor as bad weather is something inevitable. The liquid sources that are so much valued cannot be obtained so easily and their methods are not diversified, the most popular way of raising funds remains debt instruments. These put much stress on the industry but as long as wine is one of the most demanded products on the market, we can say that it has more perspectives than struggles.

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