Financial instruments under the EAFRD - Addressing the financing gap in agriculture

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Identifying the financing gap in agriculture

- Gap analysis and ex-ante assessment:
  - Hungarian Ministry of Agriculture
  - Hungarian Research Institute of Agricultural Economics
- Direct and daily contact with stakeholders of the sector
- Data on agricultural companies (partnerships, corporate form)
  - National statistical office
  - Tax declaration database
- Data on individual farms:
  - Farm Accountancy Data Network (FADN)
- Questionnaire survey (demand and supply)

Identifying the financing gap in agriculture

Findings of the gap analysis

- Individual farms
  - Suprising profitability ratios
  - Low indebtedness

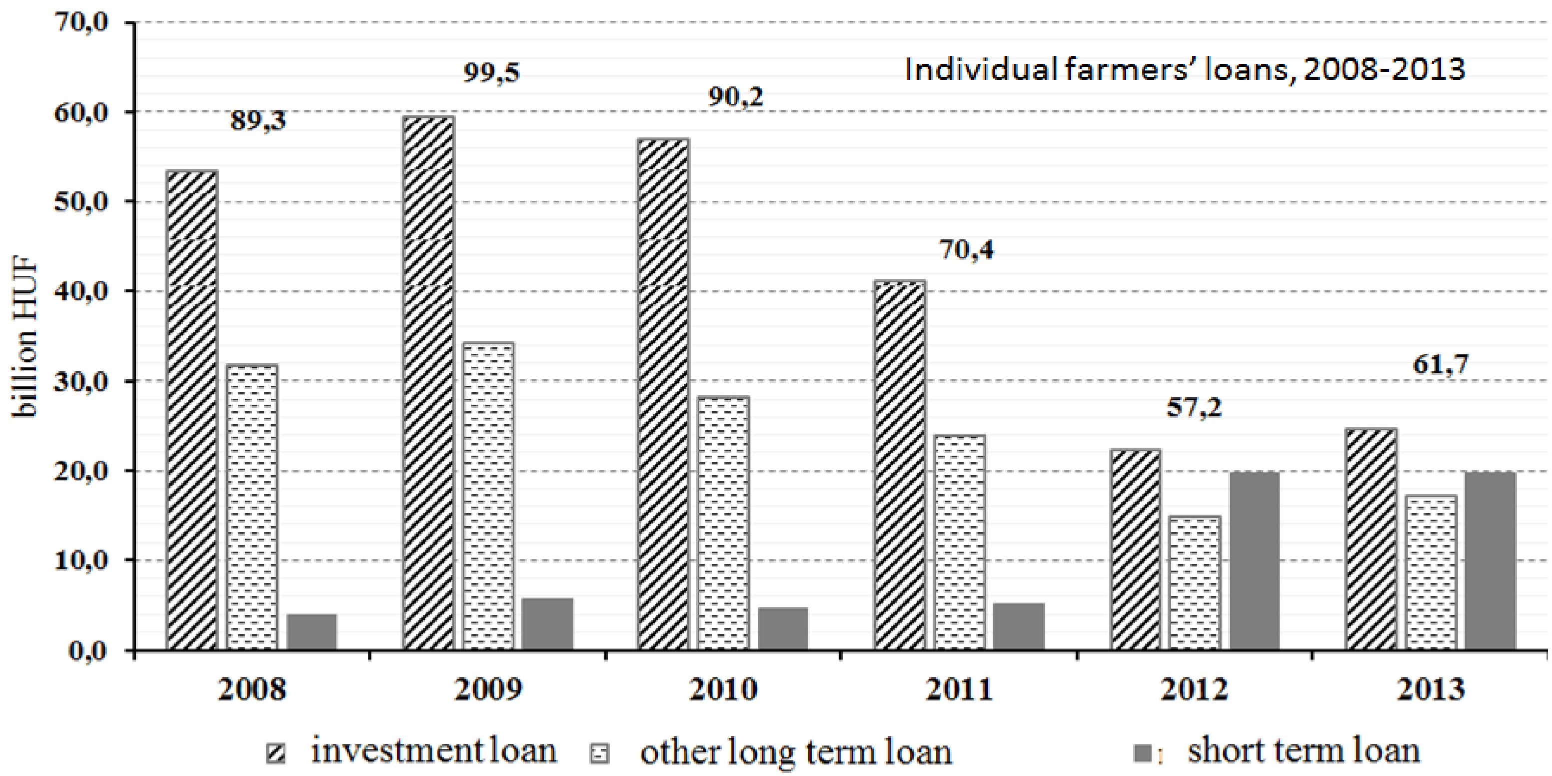
% (2013)	Individual farms	Partnerships
Return on Equity (ROE)	10.9 %	8.8 %
Return on Sales (ROS)	**35.6 %**	**8.0 %**
Return on Assets (ROA)	9.8 %	5.2 %
Capital to Assets Ratio	**89.7 %**	**59.1 %**
Debt to Assets Ratio	**10.3 %**	**39.1 %**

Source: FADN and tax data

Identifying the financing gap in agriculture

Findings of the gap analysis

- Decreasing lending for individual farmers, especially for the smallest



Source: FADN data

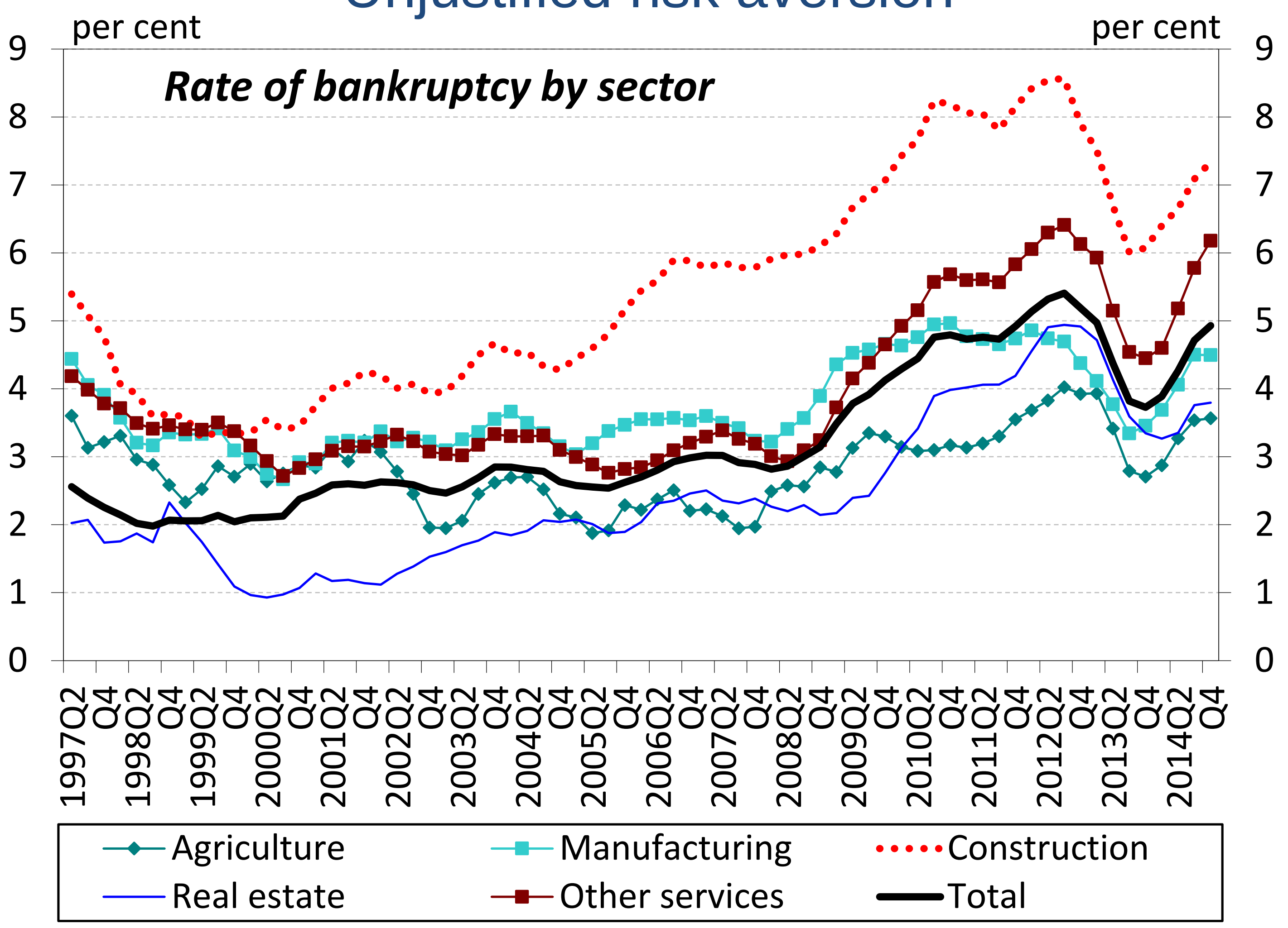
Identifying the financing gap in agriculture

Findings of the gap analysis

- Questionnaire survey (585 respondents) - obstacles to credit access:
  - Lack of or insufficient financial accounting – type of business entity
  - Low level of turnover (below 100 000 €), i.e. small size
  - Incapability to compile a proper business plan and loan application
  - Insufficient level of collaterals (almost illiquid properties)
- 60% of the respondents needed investment loan, but could not get
- Previous RDP 2007-2013 : 13,5% of the commitments (250 million €) had to be reallocated – partly lack of additional finance

Identifying the financing gap in agriculture

Unjustified risk aversion



Source: Central Bank

Identifying the financing gap in agriculture

Unjustified risk aversion

- Agricultural producers show exceptional payment discipline, strong attachment to land and farm
- Insurance for almost everything (property, yield, price volatility – new EAFRD income stabilization tool and risk management)
- National Microcredit Fund for non-agricultural micro enterprises: 1990-2014, 170 million € micro credit issued, rate of default: 5.52% (national average 4-5%)

Target group

- Micro-small sized agriculturual enterprises, mainly individual enterprises
- Above 4000 € standard output
- Crop production excluded

Sub-sectors	Number of enterprises
Individual farms	
Horticulture	15 195
Livestock production	21 776
Mixed farms	23 168
Total Individual farms	60 139

Why the traditional approach is not appropriate?

- Interest rate subsidies, preferential loans → Refinancing structure:
  Banks are the risk takers

- Guarantee instruments are derivative tools, attached to loans issued by banks

The target group is not reachable, not profitable for banks and deemed to be too risky

Refinancing method is not appropriate for the target group

Potentials and value added of financial instruments in boosting agricultural finance

Pure nature of FIs is **to finance projects that do not attract market finance**, but viable and profitable.

Ex-ante methodology Vol III: *„an assessment of bankable demand should be conducted. Indeed, the full potential demand should be corrected by removing the financing need that from an economic perspective are too risky for financial intermediaries. The demand analysis should only account for demand reflecting a real repayment possibility and exclude firm's demand that based on debt sustainability, the ability to service debt, or the return on equity would be rejected."*

What is bankable?

What is bankable from FIs perspective?

A. A project which could receive finance from banks→ suitable for refinancing model
→ no need for FIs

B. A project which is viable/profitable, but *small size/lack of double book keeping/collateral deficiencies*

Why not attractive for banks?

Small size – small revenue – high transaction costs - small profit/transaction–→

Banks will never finance the target group appropriately

Other reason:

Risk aversion (due to prudence requirements)

← **using depositors money**

Financial instruments offer a unique opportunity for
EIB/national investment banks/MAs
to create targeted finance and to reach the niche market

Potentials and value added of financial instruments in boosting agricultural finance

→ Type of FI instrument: Loan Fund managed directly by the MA (or entrusted body)

→ The FI would receive funding exclusively from the EAFRD (EU+HU) due to:

- → Private investors, if any, would hinder the lending process by:
  - →Distorting the overall objective of the Fund (reaching the target group)
  - →Requiring additional counter guarantee
- → FI (MA) will take the risks, banks are distributing agents

Potentials and value added of financial instruments in boosting agricultural finance

Adressing the needs of the target group:

– Investment loan up to 150 000 €, 10 years duration, preferential interest rate
– **Delivery of the product is made by financial intermediaries** chosen by the MA in line with the relevant rules → requirement: wide rural branch network; experience with the sector
– **Personal contact and intensive advisory service (~mentoring) is required**
– Intermediaries receive commission based on performance (taking into account rate of default and uptake) and fixed costs
– MA manages the FI: strategic decisions, business policy, tendering, monitoring

Potentials and value added of financial instruments in boosting agricultural finance

Addressing the needs, preferential conditions:

- Moderate collateral requirements: 50-70%
- Required own resources at least 10%
- High value added: Prefinancing & Finance up to 90% (rest is own resource)
- Young farmers and start-ups are also welcome ☺

Greatest advantage of the financial instrument:

The beneficiaries of the Loan Fund will be able to access investment finance from the market after the successful completion of, or already during the FI loan contract:

- Credit history (track record)
- Increased competitiveness
- Increased financial knowledge and accountancy

Thank you

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