Financial needs in the agriculture and agri-food sectors in France

June 2020

FINANCING GAP IN THE AGRICULTURE SECTOR

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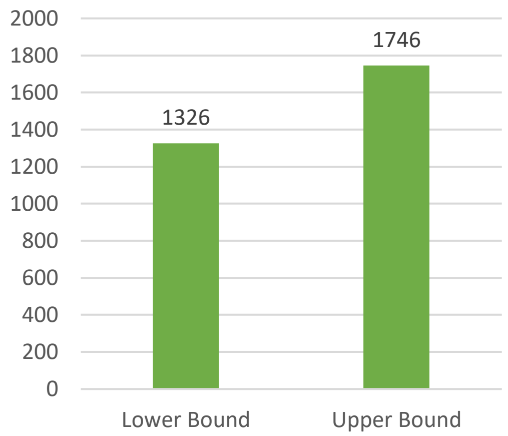
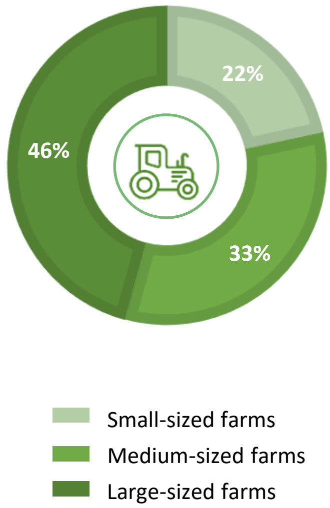
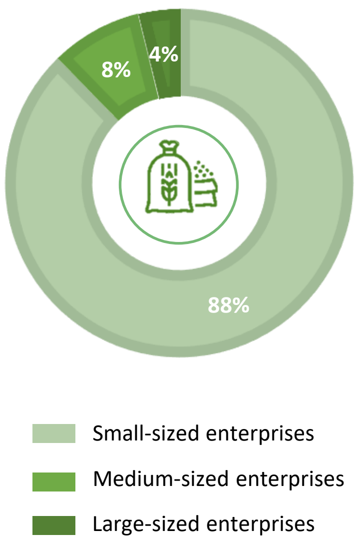


BY FARM SIZE

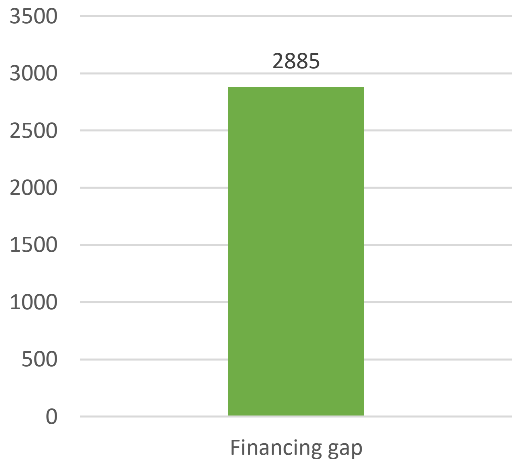


FINANCING GAP IN THE AGRI-FOOD SECTOR

BY ENTERPRISE SIZE



FINANCING GAP IN THE AGRI-FOOD SECTOR (EUR MILLION)



Source: *fi-compass* 2020

EXECUTIVE SUMMARY

This report gives an insight into agriculture and agri-food financing in France[1] by providing an understanding of investment drivers, financing supply and financing difficulties as well as on the existing financing gap.

The analysis draws on the results from two comprehensive and representative EU-level surveys carried out in 2018 and 2019. These were the *fi-compass* survey on financial needs and access to finance of EU agricultural enterprises and a survey of the financial needs of EU agri-food processing enterprises. The report does not take into account the impact of the ongoing COVID-19 health crisis and/or the effect of any new support scheme being set-up by the Member State and/or changes in legal basis and/or policies at European level to mitigate the crisis, as surveys and data available covered a period prior to its outbreak. This would need to be subject to further analyses by interested stakeholders, administrations and/or researchers.

Financing gap for the agriculture sector in France

The agricultural finance market in France has been steadily expanding in recent years, with the total outstanding loan volume to the sector increasing from EUR 47.7 billion in 2015 to EUR 52.7 billion in 2018. However, investment rates in the sector have been volatile over the same period, with a slightly declining trend, and productivity growth has stagnated. The demand for credit in the sector is highly concentrated, with most coming from large-sized farms (over 100 ha) with sizeable investment projects. Overall, 15% of farms account for 65% of the total loan volume.

The demand for finance in the French agriculture sector is driven by several investment drivers:

(i) **Expansion of farms**: With the aim of improving their economies of scale, average-size farms are expanding their capacity through investments in land and larger infrastructure. Farms are also expanding through investments in non-agricultural activities, such as renewable energy production and agri-tourism.

(ii) **Modernisation and innovation**: Farms are investing in more efficient machinery and equipment and in better performing technical facilities. This dynamic includes changes in production processes to meet consumer demand and regulatory requirements (e.g. organic and local production, animal welfare standards). Investments in digital transformation generate higher returns through smart machinery, drones and sensor technologies, as well as decision support data analytics. Innovations are also taking place in niche sub-sectors (e.g. urban farming, niche products, indoor farming, organic production, short circuits).

(iii) **Climate change adaptation**: Significant investments are linked to strategies that aim to mitigate the impact of climate change on agriculture and to improve resilience. These strategies include new agricultural practices (e.g. winter coverage of agricultural land, no-tillage, hedge plantations), as well as diversification of production. Investments in irrigation infrastructure and water reservoirs are also being made to improve farm resilience.

In addition, the need for working capital is increasing. This trend in financial needs is driven by sales growth (the increased average output level per farm implies higher input and production costs per farm), new practices to cope with volatility in input and output markets (including innovative financial solutions such as Over-The-Counter (OTC)[2] contracts) and needs arising during transition periods (e.g. for farmers shifting from conventional to organic production). Currently, a large part of working capital is provided by input suppliers, including cooperatives, through credit lines. Additional working capital is provided by banks through short-term credit and credit lines, as well as medium and long-term loans. A substantial need for additional working capital has emerged due to the high demand for investment loans, combined with the investment needs of young farmers starting new farms and for farm expansion, transition or diversification. Farmers' working capital needs are estimated to be around 20-30% of the investment amount.

1 Analysis conducted for Metropolitan France. Eurostat and national statistics used in the report include overseas territories.

2 Over-The-Counter (OTC) refers to the process of unregulated contracts for physical assets.

Overall, the conditions for the access to credit in France are favourable thanks to a healthy banking sector and low interest rates. In addition, French farmers can count on a group of financial intermediaries with a high level of specialisation in the sector and a long tradition of lending to agriculture.

However, these **specialised intermediaries have dominant market positions, with one bank controlling almost 70% of the market and four intermediaries making up almost the entire market**. Although no major constraints emerge from the analysis of the supply of finance, this level of market concentration may allow banks to be very selective in their financing decisions.

Although the supply of finance to agriculture is growing, key financing challenges remain ahead of the sector's ongoing structural transformation. **The study shows that there is an additional need for financial instruments, with an estimated financing gap of between EUR 1.3 billion and EUR 1.7 billion.** The financing gap mainly concerns large-sized farms (43% of the total gap) that require medium and long-term financing. In addition, **difficulties in satisfying increasing needs for working capital finance have been highlighted** in the analysis. Interviewees reported that financial institutions generally do not adequately finance the working capital of new risk management practices developed to cope with the increasing volatility of farm income. Similarly, there is a financing deficit for the working capital requirements of new investments in often large and innovative projects. This segment of the gap is likely to increase in the near future.

Overall, the main obstacles identified that constrain access to finance relate to:

- low and volatile economic margins that increase banks' risk perception;
- applicants' lack of business history or financial data on innovative investments or new production practices, which may increase a bank's reluctance to finance an investment; and
- lack of sufficient assets to be used as collateral and a lack of own capital may also be obstacles.

Banks also signal difficulties arising from the increasing size and complexity of agricultural investments. The ownership structure of larger enterprises is also evolving towards more complex financial structures and financing needs.

New entrants and young farmers are likely to account for a significant share of the financing gap. Interviews revealed that farmers who take over existing farms or establish their own farms face difficulties in fully financing their projects. For individual farmers, some of the challenges arise from a lack of personal equity that is needed to secure large long-term loans. For corporate farms with new structures (e.g. multiple shareholders, external investors, complex and diverse production with innovative investments), the challenges stem from new financial needs that banks are not always ready to satisfy.

RECOMMENDATIONS

- Several financial instruments, with EAFRD, EFSI and national/regional resources, have been put in place during this programming period at both the national and regional level. However, most of them have only been created very recently and so it is not possible to fully assess their impact on the financing gap at this stage. The analysis suggests that they may be unable to significantly reduce the rather substantial financing gap by the end of the current programming period. At a later stage, a review of these instruments should be conducted. This review should verify the adequacy of the available capital funding, the concrete ability of the instruments to address the constraints of the most affected enterprise segments, as well as their performance and efficiency. Based on such a review, the scope for establishing new initiatives, including under the CAP Strategic Plan 2021-2027, could be evaluated.
- To address the needs of young farmers, the opportunities offered by the new legal framework, such as the easier combination of financial instruments, grant support and interest rate subsidies, or the possibility to finance the purchase of land for young farmers, could be embedded in any future financial instrument under the CAP Strategic Plan 2021-2027.
- Considering the increasing number of more complex farm legal and ownership structures, the feasibility of a pilot equity or quasi-equity instrument might be analysed. Such an analysis could also focus on the need to support

start-ups and, in particular, young farmers and new entrants with innovative ideas, as these two groups were found to be particularly constrained in their access to finance.

- Difficulties in addressing new and increasing needs for working capital, especially for medium and large sized agricultural enterprises, which also constitutes a significant part of the financing gap, could be addressed by providing stand-alone working capital finance through EAFRD-funded financial instruments, which will be possible under the new legal framework.

Financing gap for the agri-food sector in France

The investment dynamic in the French agri-food sector is positive. Investment in the French agri-food sector grew by 35% over the 2014-2017 period, reaching an estimated EUR 13-14 billion in 2018. Approximately EUR 10 billion is invested in tangible assets, between EUR 3-4 billion in (non-tangible) innovation assets and EUR 2 billion in related working capital requirements. Medium and large-sized industrial enterprises account for 77% of the investment in the sector.

The demand for finance in the French agri-food sector is driven by several investment drivers:

(i) **Capacity expansion**, with French farmers investing in machinery, equipment and buildings.

(ii) **Production efficiency and product innovation**, which is related to the ongoing digitalisation of most enterprise functions.

(iii) **Compliance with stringent standards**, especially with regards to enterprises' improved energy performance and waste management practices.

The supply of finance to the sector is provided by a large number of private banks and one public institution that supports industrial and economic development (Banque Publique d'Investissement - Bpifrance), as well as private sector funds and mutual guarantee associations (Unigrains, Sofiproteol, SIAGI, SOCAMA).

The supply of finance to the French agri-food sector is relatively unconstrained. This is shown by the growing outstanding loan volume to the sector (44% increase from 2013 to 2018), which reached EUR 38.2 billion in 2018. The difficulties highlighted by banks only relate to the financing of innovative projects involving non-tangible assets that cannot be used as collateral.

However, an estimated financing gap of EUR 2.9 billion exists in the sector. Approximately 88% of this gap concerns small-sized firms. In terms of financial products, 62% of the gap relates to long-term loans. Although medium-sized enterprises account for around 8% of the financing gap, they may also face important constraints based on the feedback of qualified stakeholders interviewed for this study.

Overall, the main obstacles identified that constrain access to finance relate to:

- high business risk related to low profitability;
- insufficient collateral or guarantees, especially for small and medium-sized enterprises, and
- a lack of credit history for start-ups.

Large-sized enterprises have access to the bond market and benefit from good risk scoring. This means they can finance their needs through a diverse range of funding sources and that they are less financially constrained.

Based on feedback from qualified interviewees, existing public support measures do not reach a significant share of small enterprises. This is due to the thresholds of investment volume required per project and the complexity of the administrative work required to support applications.

RECOMMENDATIONS

- Despite the diverse offer of public support, a significant financing gap has been identified within the sector in relation to start-ups and small and medium-sized enterprises. The available public support tools seem to lack a specific focus on the agri-food sector and investments in non-tangible assets for innovation. Therefore, an assessment of the current instruments, including on their ability to address the financial constraints of these target groups, investments in non-tangible assets and the agri-food sector more generally, could be helpful for taking corrective action and in making these instruments more efficient.

- The possibilities offered by the new EAFRD legal framework, including the easier combination of financial instruments and grant support, as well as the provision of stand-alone working capital finance, might offer the opportunity to design a dedicated financial instrument (in the form of a guarantee or risk-sharing loan fund) with an increased focus on the above mentioned segments. It will be beneficial if new initiatives related to financial instruments are in synergy with successfully running schemes at the national level, or if they continue their implementation. The presence of a single CAP Strategic Plan 2021-2027 may facilitate the set-up and outreach of any financial instrument supported by it.
- The possibility to set-up a pilot equity or quasi-equity financial instrument that supports start-ups with innovative projects might also be analysed.